The Canadian Chartered Accountant

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THE TAX REVIEW

THE CANADIAN INSTITUTE OF CHARTERED ACCOUNTANTS

[S]EPTEMBER 1954

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SWEETNESS and LIGHT

By Jay Vee

For Men Only

HEARING a mild rumour that Canada may soon have its first woman Cabinet Minister, several of our readers are becoming alarmed at the invasion of women into hitherto exclusively masculine strongholds. The edge of the wedge is getting far too thick, they say. Next thing, women will start reading the sporting page of the daily paper, and when that day of doom descends what sanctuary will be left?

But take it from us, there is one activity in which men will never be challenged, and that is fishing. After a few recent first-hand experiences we want to go on record that in our opinion women are just not cut out for this noble and ancient sport.

In the first place a woman is used to dealing in approximate measurements, such as "a small bowlful", or "a decent-sized piece". But a fisherman is obliged by law to be annoyingly exact (unless of course he is talking about a fish that got away).

"That pickerel looks pretty long," we said as we hauled in our first catch and in our mind's eye saw it filleted and dipped in egg batter for frying.

"Hmm, only 14⅛ inches — not a keeper," our companion retorted as he threw it back in and our hopes with it.

And not only is a fisherman exact, but so insistent on nothing but the best. On our next strike we were reeling in one

Sweetness and Light

of the prettiest fish found in fresh water. "Yah, you got yourself a ruddy sunfish," came the disgusted groan from the other end of the boat.

"Well, let's keep him anyway," we ventured. "We may not get a pickerel or a bass and there would surely be enough flesh on him for one meal."

Now any woman would regard such a suggestion as very practical. Yet it met only with stony silence as the Sunfish was flung back to his geology class, or whatever he is supposed to learn in his school.

There is an even deeper difference which prevents women from being ardent fishermen. A woman doesn't mind being outsmarted by a man but would be furious to think that a scaly cold-blooded creature of 10 or 12 inches could make a fool of her. A man, on the other hand, though he hates to be outsmarted by a woman, is quite resigned — nay, even full of admiration — when he comes off second best to a fighting black bass.

Years ago at Lake Simcoe we remember that all the male cottagers along our beach were after one particularly reluctant bass named Ogopogo. In a state of ennui, Ogopogo used to drift around under a big launch not far from shore and during the heat of the day delighted in tantalizing the fishermen by letting them see his large lordly shadow. But every kind of bait and lure simply bored him. Worms, night crawlers, frogs, June bugs, flatfish, spoons — he had known them all in his day and had shaken himself free every time. Of course a woman could never bring herself to cater to a fish in this manner, but the men kept on trying each day from misty dawn to mosquito-time, and Ogopogo's prestige grew and grew. Finally in late August our grandfather in a mood of whimsy

Sweetness and Light

put a collar button on his line and at long last Ogopogo really hit hard. Some will tell you that he was intrigued by the novelty of the bait. Personally we have always believed that he knew both he and Granddad were getting on in years and perhaps neither of them would be around the next summer, and by this magnanimous gesture he was sure to find immortality in at least one or two snapshot albums. At any event he gave up rather graciously as bass go and weighed in at nearly 5 lbs.

Well, if the infiltration of women gets too much for your world, dear reader, all you have to do is row or put-put out to that special spot in the narrows or by the weeds or 100 yards off the big point. There you can drop anchor and wait for your Ogopogo. On behalf of womankind we assure you, you will be left strictly alone!

The Canadian Chartered Accountant

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COMMENT AND OPINION

Auditors are Company Officers!

A FEW weeks ago the Court of Appeal of British Columbia ruled that the auditor of a company is an officer of the company and therefore obliged to submit to examination for discovery touching the matters in question in a lawsuit brought against the company. So far as we know this is the first reported case in which it has been held that a company's auditor can be compelled to disclose the basis of his client's case to an opposing litigant, and it is not a decision which accountants will applaud. While it is true that the position which the auditor of a company holds is described as an office, the function of the auditor is to examine and report on the financial transactions of the company for the information of the shareholders, and not to conduct the affairs of the company, which is the function of the officers of the company as that term is usually understood. To describe an auditor as an officer of the company, however technically correct it may be for legal purposes, seems therefore a patent misnomer to accountants and, moreover, in some subtle way, to reflect on his independence.

The ruling of the British Columbia Court came in the course of a civil action brought by the shareholders of a certain Dominion company which had a number of affiliates incorporated in British Columbia. The plaintiffs charged fraud, falsification of accounts, concealment of profits and inter-company manipulations resulting in loss to the plaintiffs. It is obvious that no one would be better informed of these matters than the auditor of the defendant companies, and it is perhaps not altogether surprising that the British Columbia Courts approved the plaintiffs' application calling on the auditor as an "officer of the corporation" to appear and make discovery of the defendants' case. Indeed, we understand, the Courts throughout Canada have tended to give a very broad construction to the phrase "officer of a corporation" where it is a question of discovery before trial and the present decision only continues the trend. Thus a train conductor has been held to be an officer of a railway company for this purpose.

Nevertheless we hope we may be forgiven if we express the opinion that the relationship of auditor to company is not quite the same as that of a train conductor to his employer. The auditor is not a servant of his company, he is not subject to the latter's direction or control in the performance of his duties. Moreover the duties cast upon him are duties imposed not by the company but by the Legislature, and are duties which must be performed regardless of the company's wishes in the matter. The auditor can of course be called as a witness in Court and be examined and cross-exam-

ined as to his knowledge of the matters in issue, but it is regrettable, we think, that the law assimilates him to an officer of the company for purposes of pre-trial discovery, as the British Columbia Court of Appeal has held that it does.

Saskatchewan Rejects Regulation

LAST March in this column we discussed at some length the report of the Royal Commission on Public Accountancy in Saskatchewan, which was most flattering to the Institute of Chartered Accountants. The Commission's chief recommendation was that the Institute should be the sole recognized professional society of public accountants in the Province, and that a public Board similar to the Boards now functioning in Nova Scotia and Ontario should be established to grant licences to practise to non-members of the Institute. Having recommended exclusive professional recognition for the members of the Institute, however, the Commission further recommended that the Institute should not have exclusive control over the qualifications of applicants for admission, and that, following the example of Alberta, independent authorities should be set up to pass upon the education and experience of candidates for admission.

It came as considerable surprise when the above recommendations of the Royal Commission were not accepted by the Saskatchewan Legislature. The Law Amendments Committee of the Legislative Assembly, to whom the report of the Royal Commission had been referred, was unanimous in rejecting the above recommendations of the commissioners.

The House Committee agreed with the Royal Commmission that one professional accounting body of the highest academic and professional standard was the ideal to strive for, but it did not think that the way to attain that objective was to deprive existing practitioners other than chartered accountants of legislative recognition and the incentive for improving their standards that would follow from such recognition. Neither, on the other hand, did it think that the proper course was to open the doors of the Institute to all accountants engaged in public practice in the Province.

In result the Committee recommended that Saskatchewan should follow the example of Ontario, Manitoba, and British Columbia in granting legislative recognition to a second society of public accountants. This course, the Committee said, would have the effect of enlarging the professional base without attacking the autonomy or lowering the standard of the Institute of Chartered Accountants, and would enable a hitherto unorganized group of accountants of like qualifications and aspirations to give effect to their desire for legislative recognition and for the attainment of higher professional standards. The Committee added that when the newly recognized society attains professional standards equal to those of the Institute of Chartered Accountants consolidation of the two societies should be the logical and inevitable sequel.

Accordingly for the time being there is to be no licensing legislation in Saskatchewan, that is, no limitation on the right to practise public accounting in the Province, but the House Committee recommends that continuing study be made of the practicability of a general accountancy Act with a licensing feature incorporated.

Of Canada's ten Provinces there are now four with regulatory legislation embodying a licensing feature and six without such legislation. In the former category stand, from east to west, Nova Scotia, Prince Edward Island, Quebec, and Ontario. In the second category stand Newfoundland, New Brunswick, Manitoba, Saskatchewan, Alberta, and British Columbia.

The Accountant in Modern Society

By Ian T. Morrow, C.A., F.C.W.A., A.T.I.I.

The trend of opportunities for today's accountant whether in public practice or in industry

IT is only possible to consider the place of the accountant in modern society at a particular moment of time. We pause and assess, assuming that time has stood still long enough for us to look over the vast fabric of modern society and see the pattern, the golden thread our profession forms. Events press on so fast that much of what is said today will soon be as out of date and old-fashioned as yesterday's newspaper.

The centenary celebration of the oldest body of accountants, the Institute of Chartered Accountants of Scotland, provides a convenient moment to study briefly where accountants stand in relation to the rest of society — to industrial society, for it is the rise of industry and commerce and the giant expansion of western machine civilization which has provided the conditions making possible the growth in numbers and prestige of accountants. It is the enormous increase in urban living which has made the opportunities that have been grasped by our profession. It is not my intention to suggest that my few remarks apply to chartered accountants only, or even to qualified accountants; many are true of accountants as a whole. Nevertheless, the decisive influence in shaping the course of accounting and developing the modern accountant has been the chartered bodies, and no mean part in this development has been played by the body whose centenary is now celebrated.

THE PUBLIC ACCOUNTANT

The basic concern of the profession has been, and must be, to perform the duties of public accountants, to serve the public with unquestioning integrity, and to put the public need before personal needs, despite the impact of divided loyalties and conflicting interests, because the public accountant's aim is truth and justice as he sees it.

I will therefore briefly deal with the various aspects of the work of public accountants before dealing with the work of those accountants who are not directly employed in the profession.

Training

The leaders of the profession, in their desire to see the continued development

An address to the Institute of Chartered Accountants of Scotland on its centenary, June, 1954

of the profession's strength, give a great deal of time and thought to considering the training of apprentices. They do so in order to ensure that that training will equip oncoming generations to deal with the ever-increasing range of problems presented to accountants and also in order to see that the profession continues to produce what I believe is a unique blend of vision, judgment, and common sense out of, at times, unpromising material. The influence of the profession on the economics of our modern society is a tribute to the success which has attended their efforts.

We know what an apprentice has to go through. At an early stage in his training he is instructed to carry out a certain part of the audit program, frequently by a lordly being only a year or two older than he is. He may find that his work is not subject to detailed check; he is trusted to do what is asked of him, and thus his self-discipline is built up. The apprentice must question, politely and persistently, clients' staff on points which are not clear to him, and if he is unable to satisfy his seniors he may be humiliated by being sent back again, or, worse still, a senior in exasperation may get the answer himself. He is thus taught the value of tact and precision and the shortage of facts, and all the time he is developing his judgment and a healthy scepticism for unfounded opinions. It is not the mere book-learning that does the job, nor the attendance at classes, nor the passing of examinations, essential though these be in the mastering of our craft. If that were all that was required there would be no need for elaborate apprenticeship schemes. It is the experience acquired in handling people, with little except moral authority to back him up, the understanding of how widely different views may be arrived at from the same set of facts, the acceptance of responsibility at an early stage for the work done.

This is not an exhaustive survey of the qualities which are developed during the apprenticeship, but it is, I think, fair to say these are some of the qualities which are admired in our profession by the rest of the world. If these are developed during the apprenticeship the addition of specialized knowledge can be left until after the apprenticeship.

Auditing

A great amount of the work of the public accountant is concerned with auditing and preparing the accounts of the multitudinous companies and firms which make up the mosaic of industry and commerce. The practice of auditing is continually evolving and if accountants still have a bias in favour of understatement it is well that they should remember the salutary check that this tendency received in the *Royal Mail Steam Packet* case. The public requires that the accounts, when audited, be reasonably clear and fair. The directors may wish, for the best of reasons, to put a good face on a disappointing year or to depress a good year, but auditors must, as far as possible, refuse to be a party to either. They must present accounts which are fair to the shareholders, to the outside world, and to the directors and executives. This duty is faithfully discharged.

The increasing use of well known management techniques of cost accounting, production control, material control, and work study has provided the auditor who has some knowledge of these techniques, and knows how to use the information provided, with a wealth of checks on the financial accounts. The demand for speed in the preparation of accounting information has meant a great increase in the use of mechanical accounting. The reorientation of accounting effort in industry in the direction of informing management has given rise to a sense of grievance on the part of some

audit clerks, who feel that the accounts no longer serve their original function of making the audit easy.

At least the advances in accounting techniques have reduced the drudgery of auditing and the necessity for painstaking detailed checks, and, in this connection, an increasing use of statistical aids such as sampling is to be expected.

Internal Audit

In addition to public auditing many members are engaged in internal audit. In the larger industrial and commercial undertakings, and of course in the nationalized industries, the development of the internal audit has removed from the public auditor a great deal of the detail work. Internal audit is, however, bringing forth a technique of its own which is expanding its responsibilities far beyond those of mere checking to forms of efficiency audit. Care has always to be taken to see that the independence of the internal audit staff is not compromised. The advantages are that the client gets frequent reports which assist the management and the professional firm, relieved of a great deal of worrying detail, is able to concentrate on the principles and to speed up the completion of the work. It also provides an excellent channel of entry into industry.

Taxation

Important though auditing is, the field which has expanded most rapidly in the last generation in the public accountant's office is taxation. Here the public accountant has won for himself a startling position. He is paid by the taxpayer and trusted by the tax gatherer. He is trusted by his client to make a fair and just settlement and he is trusted by the Inland Revenue to make a full disclosure of the facts. The work has been so well done that it is comparatively infrequent for appeals to be made to the Courts.

Investigations

Industry is never static. There is a continual expansion and decline involving new capital and amalgamations, and nearly all the financial arrangements are settled on the basis of an accountant's report made from the results of an investigation into the affairs of the undertaking.

Not every firm has the opportunity to do this work, but it provides a break in the day-to-day work of auditing and taxation. While it calls for the exercise of judgment it is interesting and fruitful work. It may be that as the public expectation of what chartered accountants can do increases, investigations will cover a wider field than they do now. They may deal with the efficiency of management, incentive schemes, production control schemes, commercial organization, and so on.

Consultancy

Many accountants are employed by firms practising as management consultants. These firms, in the majority of instances, are not under the control of the profession, but what in many instances was stated as an engineering service now includes accountants, since the discovery has been made that the accountant has a considerable contribution to make to management consultancy both in the obvious fields of installing costing systems and stores control and in the less obvious field of organization, production control, and incentive schemes. Nearly all the men who are so engaged have had considerable executive experience in industry beforehand and many are partners and directors of the firm and companies for whom they are working. A great deal of this work is of the sort which could be, and in many cases is being, done by the profession, but it requires the setting up of specialist firms or specialist departments in practising firms. There are few specialist firms of chartered accountants

dealing exclusively with consulting work. It is a new development. The advantage of a specialist firm is that it may be called in by firms with a more normal practice without any possibility of conflicting interests. If firms wish to develop this kind of work it has been proved by experience that they should set up specialist departments, staffed by men who do little other work. Many large firms in the U.S.A. have done this and they have said that they always hoped in the beginning that the staffs would be interchangeable between auditing and consulting, but in every case this proved impossible.

Directors of Companies

Many practitioners are part-time members of boards and it is becoming recognized that the practitioner brings a wide knowledge of business, a healthy respect for facts, considerable scepticism about forecasts for the future, and a mature judgment which adds greatly to the deliberations of the board. Apart from being actual members of a board, many practising members are looked upon by their clients as guides and friends when dealing with major matters of policy. Today many flourishing industrial concerns owe a great deal of their success to the advice given to the pioneers by their auditors.

Government Commissions

It is becoming a welcome practice for the government to invite chartered accountants to sit on many of their commissions. Many members of the commission have a limited knowledge of industry and business, and the contribution of the accountant can be invaluable through his practical knowledge of their workings.

THE ACCOUNTANT IN INDUSTRY

Industry's demand for accountants with the right balance of accounting knowledge, judgment, and character appears to be insatiable. Industry requires accountants for a wide variety of purposes: as secretaries, chief accountants, financial directors and, with increasing frequency, as managers. Fifty years ago Richard Brown wrote in his "History of Accounting and Accountants": "The employment of accountants as bookkeepers is no doubt one of the humbler walks of the profession". It is quite probable that today many of the members of the profession in industry would be quite incapable, personally, of keeping books in a way that would satisfy their brother public accountants. The demand for accountants in industry seems to flourish in every form of industrial society — free capitalism, state capitalism, and totalitarianism. In a recent article in *Fortune* it is said to be a Russian joke that when a manager attempts to engage a chief bookkeeper he asks each applicant "How much is 2 and 2?" The first applicant says "4" . The second says "22" and so on. Finally a man answers "What you would like it to be". That man gets the job! It is not yet, however, an answer that is likely to determine the successful applicant in British industry.

Today it is more and more common to appoint a qualified man to a position in industry within a relatively short period after he takes his degree in order that he may acquire the experience and specialized knowledge necessary. Chartered accountants do, however, enter industry from the profession at various stages of their careers: some in the first year after they qualify, some after a few years in the profession, and others even after they have become partners. Nearly

all chartered accountants who enter industry and commerce are permanently lost as practising accountants, although some do return to practice. The majority who have experienced the different atmosphere and conditions which apply outside the profession are reluctant to return. I think more of my fellow chartered accountants than to give credence to the suggestion that the main attraction of industry and commerce is larger salaries and pensions. The work is positive and creative and has wide attractions to certain temperaments and minds.

Training

As management in industry becomes clearer on what it requires from accountants it is becoming more selective in those to whom it offers employment. It is demanding more and more from the accounting service. Management is no longer satisfied if the accountant is an expert on finance, gets on with the auditors, and has some knowledge of taxation. The chartered accountant who enters at an early age may be fortunate enough to join a company which has a training scheme, or he may be given a relatively junior position in either the cost accounting or financial accounting branches. If he is wise he will endeavour in these early years not only to specialize in industrial or management accounting branches, taking specialized examinations such as those of the Institute of Cost and Works Accountants, but to master, as far as a lay man can, the technical intricacies of the industry in which he is working. Once he has a reasonable working knowledge of one branch of industry, he will find in his future career that it is relatively easy to acquire similar knowledge of other branches.

Two Categories

The accountant in industry today is expected to be a member of the management team along with the designers, the salesmen, the personnel officers, and the production people. Because of his particular function, he impinges on each and every one of the other functions. In the handbook published on the occasion of the Scottish Institute's centenary, it is suggested that the accountant's role in industry falls into two broad categories:

(1) The secretary, comptroller, chief accountant, or cost accountant, in which capacities the accountant is called upon to provide the financial information which management needs in making policy decisions and to show the effort of these decisions.

(2) The director or financial adviser, in which capacity he shares the responsibility for making policy decisions.

In these two statements is concealed a revolution in thought, a revolution in attitude to what the accountant can and should provide in industry. For a long time the accountant was regarded as a mere recorder, an historian of the past, but the statements which I have quoted make it clear that the accountant has now to provide information on which the future of the company will be decided. It is difficult, if not impossible, for an accountant to produce a comprehensive statement which will give guidance to management on every decision. He must know which way management is moving and for what purpose the information is required, so that he can present his statements to bring out such information as is pertinent to the policy discussion on hand. It is obvious that management requires quite different financial and accounting information when it is discussing capital replacements from when it is discussing sales policy.

These two statements in the centenary handbook also emphasize that a great deal of management function is making decisions about the future. The past is only relevant insofar as it illuminates the

path ahead. It is well to remember that in industry and commerce, as everywhere else, making a decision is an exercise of choice. No company, no undertaking, however vast its resources, however great its achievement, has unlimited choice. The decision must be to discard one thing and to push on with another, and a great deal of the unpopularity which accountants have in industry derives from this fact. The accountants are recording the stark economics of the situation. For example, they may point out that the company or the undertaking cannot spend lavishly on developing and renewing its production plant and at the same time carry on a vigorous and expensive advertising policy. It may be necessary to carry out many policies below the optimum level or it may be that management wishes to put all the strength behind one particular policy. That is for them to decide. It is for the accountants to indicate that the resources will or will not be adequate to carry out the decision. It is also their duty to point out, where necessary, that, however desirable certain decisions are, it will outrun the capacity of the company to bring them to fruition.

A Creator of New Techniques

The accountant, in preparing all the various statements, must be able through personal knowledge to assist all sides of the business in arriving at the right decision. He must be able to help the works manager in deciding priorities for capital expenditures, the designer on priorities for development, the sales manager on commercial policy and credit terms, and the managing director on matters of general policy such as whether to invest more money in stocks and where the necessary capital for expansion is to be obtained. The contribution which the accountant in industry is able to make to the formulation of policy is well recognized. Yet it is probably true to say that the major strides which have been made by the accountants in industry in recent years have been in the development of techniques to assist management in the day-to-day and month-to-month control of business. The principles have been known for a very long time; it is their application that has lagged. The value of any system of control by costing and accounting can only be as good as the underlying data, which in nearly every case comes from the works, and until management engaged on production were prepared to measure output and effort with reasonable accuracy, there did not exist any satisfactory foundation upon which a system of control could be erected. It is essential that accountants engaged in industry understand thoroughly the techniques of production control and time study. If time study as such does not exist, they must know the methods by which piecework prices or standards of performance are set. If these techniques are clearly understood it is possible to create accounting records on an economical basis which will be of real value to management.

A Transcriber of Plans Into Figures

Industry must always have a plan. It may be that through changing circumstances plans have to be discarded or modified but in essence a plan must be such that by using the existing assets it is hoped to get back 21/- or 22/- for every 20/- that is spent. This may seem rudimentary to accountants, but it is surprising how often in discussions in industry it is forgotten. Forward planning in detail, or budgeting (to give it its more conventional name), means setting out what is expected to be spent to achieve certain output, certain sales, and certain profits. If, when all the various calculations have been completed, the plan is accepted as satisfactory, it then becomes the yardstick by which the success of operations can be measured.

Money is the most satisfactory common language into which to translate all plans. As the operations take place the output from the works is measured and the efficiency of the operators and the machines is similarly measured. These will be compared with the plan and the differences will be reported to the various levels of management. The object of all the work is to ensure that management takes action. While it is true that very little will happen unless top management insists on action being taken, it is also true that an accountant, knowledgeable of the ways of men, can assist management to come to a decision by the way he presents and discusses the figures. Events in industry move fast and the accountant in industry must present information for control in the shortest possible space of time. This means first-class office organization and the use of estimates by the accountant. It is not unreasonable today to ask that, even in a large company, the trading figures should be ready within ten days of the end of the month. Accountants in industry have in recent years made great strides in the technique of swift presentation.

I must digress for a moment to the effect of changes in the value of money in which the plan has been mainly expressed. The vast inflation and the debasing of the currency has set the accounting profession a serious problem. This problem was created by others, but the accounting profession is blamed because it is having difficulty in solving it. The difficulties of solution have at last made the industrial community aware of the dangers, the danger that under existing conventional accounting the tax gatherer is taking part of the permanent capital and that by under-pricing industrialists may be giving to the customer, unknowingly, some of their capital. I am sure that it is the accountants' duty to make sure that management is aware of the effect on costs and profits, but that it is for management to decide what is to be done internally, until the government can be persuaded to take action externally.

Many accountants are today being promoted to the positions of general manager and managing director, not because they are good accountants but because they are considered good managers. Today it is almost as likely that an accountant will be promoted to the highest post in the company as a member of any of the other functions. This is an indication of the high regard in which accountants are held by boards of directors. There is now no senior post in industry to which the ambitious young accountant cannot aspire. The managing director's pen is within the grasp of every apprentice.

Conclusion

I have endeavoured to compress the whole of the story of what accountants are doing today into a short space. I am afraid that the emphasis which is placed on some aspects of the accountant's work at the present time will seem to our successors to show an ill-balanced judgment, but we are prisoners of our environment.

Without an accountant's skill modern society would not function. Today the practising accountant has gained the confidence of industry and commerce, both as an auditor and as an adviser. The problem is not that the industrial community will not turn to the practising accountant but rather that they will expect from the practising accountant far more than he can reasonably accomplish.

I have avoided as far as possible any predictions about the future, but if I may venture one suggestion it is that the profession may in its next stage of development have to decide whether it is going to follow law and medicine and consciously create specialists in the different fields, or continue to be satisfied with providing the basic training only.

Integration of Cost Accounting and Financial Accounting Concepts

By A. S. Donnelly, A.C.A.A.

An examination of how cost accounting fits into the general accounting scheme of a business

ACCOUNTING no less than other fields has seen a remarkable growth in specialization in the last few decades. A nineteenth century accountant would be amazed if he could see the extent to which this specialization has proceeded — the development of separate specialties such as taxation, auditing, company work, bankruptcy and so on, to say nothing of the many fields in which the commercial and industrial accountant renders valuable service to his employers.

With this development has come a greater recognition of the importance of accounting. There has been more appreciation of the value of an accountant's services; businessmen have begun to realize in varying degrees that the accountant can be a valuable help in controlling waste and increasing profits. All this is gratifying, but there is another aspect of the position that is not so gratifying. It is this: in Australia at least there is little evidence of a sound approach to the problem of integrating or coordinating cost accounting and financial accounting.

What is the Problem?

That this problem exists is due mainly to the rapid development of accounting and particularly cost accounting. The latter branch became so specialized that many cost accountants, financial accountants, and executives regard it as something quite apart from accounting. They overlook the fact that cost accounting and financial accounting are both parts of the art or science of accounting. Ultimately they have a common goal though their means of reaching it may differ.

At one extreme, there are businesses where there is no liaison at all between the cost accounting and financial sections. In fact there may be thinly disguised hostility. Perhaps there is a qualified cost accountant unhappy because he is inferior to the financial accountant despite his additional post-graduate qualification. Or there may be a financial accountant who regards the costing section as so much duplication and wasted effort.

There are many public accountants who have never bothered to learn very much about cost accounting. They have

A paper read to the Accountants and Secretaries' Educational Society (Inc.), Brisbane, May 6, 1953

been so pre-occupied with taxation and auditing that they have come to regard anything outside those subjects as being of no real interest. They have failed to realize that in applying the concepts of cost accounting — or some of them — their clients can make substantial savings. Hence their clients' businesses have suffered because of this lack of interest.

The above is not universally true. We all, no doubt, know of businesses where the cost and financial sections work together without overlapping. And there are public accountants who realize the benefits of cost accounting and have been able to offer useful advice along these lines to their clients. But the majority of Australian businesses would be found somewhere between these extremes. Probably in the majority there would be at least a vague idea of the need for integration — integration of concepts or principles not merely reconciliation of two sets of figures.

Unless the concepts, principles, or whatever you may call them of cost accounting and financial accounting are integrated, accounting cannot render anything like the best possible services to any business concern. This applies to all types of businesses — the traders as well as the manufacturers, the small as well as the large. If a cost accounting system is in operation, lack of integration means either extra costs or less than maximum efficiency from the accounting departments.

But what of the small concern? Or the trader, the professional man, the service industry, or any one of the other many types of businesses to which the application of cost accounting in the commonly accepted sense of the word does not seem appropriate? These too can benefit. By studying the concepts of cost accounting the most suitable applications can be worked out without the trouble and expense normally associated with a cost system. Later I shall demonstrate with a practical example how this can be done.

Can the Problem be Overcome?

Before considering how the problem should be tackled, you may well ask whether it can be overcome. To answer this question we must look towards America where accounting in all its phases is more fully developed than in this country. The team from the Anglo-American Council on Productivity who travelled to U.S.A. to study management accounting were impressed by the way in which cost accounting and financial accounting in that country are parts of one integrated whole.

Indeed in America this outlook on cost and financial accounting has had something to do with the creation of a new executive position, i.e., the controller. It is the task of the controller, in addition to many other duties, to have reports prepared for the Board and other executives. He supervises both the costing and general accounting sections. But as they are coordinated he has no difficulty in presenting really useful reports. He is not concerned with presenting a summary of this record or that; he is interested in obtaining from the integrated accounting system information that will really help management.

A few years ago Mr. A. A. Fitzgerald said he agreed with the view "that eventually we will get back to the common term of accountant, which will include both cost and financial accounting". (From the Cost Bulletin No. 25, March 1949, The Australasian Institute of Cost Accountants).

The Special Features of Cost Accounting

To integrate the concepts of financial

and cost accounting it is necessary to know just what these concepts are. As the concepts of financial accounting are more widely known and understood let us examine cost accounting to see where the viewpoint of the cost accountant may differ from that of the financial accountant. Many of the practices of the cost accountant and financial accountant are similar in that both use ledgers and the double entry system. So if we isolate those features which are peculiar to cost accounting — or more commonly found in cost accounting — we have a foundation on which to build.

Possibly the following are the more important of such features: —

1. Cost accounting is non-historical in outlook; it shows more interest in the present and the future than the past.
2. Cost accounting is more objective; the decisions of the cost accountant are more often based on logic rather than some time-honoured but perhaps illogical custom.
3. There is more regard to non-financial data — quantities etc. — in cost accounting than in financial accounting.
4. Cost accounting makes use of the "principle of exceptions". It is concerned with emphasizing departures from normal or expected results.
5. In cost accounting cost is not regarded as one inflexible figure for all purposes; there are several interpretations of cost each more suitable than the others for a particular purpose.
6. Cost accounting makes more use of "internal" records.

The above are not the only special feature of cost accounting. Nor do they represent the whole of the concepts of that branch of accounting. But they are the most important to consider for the present purpose which briefly is:

1. To examine briefly each of the above special features.
2. To see how cost accounting in these features differs from financial accounting.
3. To find if these concepts or some of them may be applied even where a cost accounting system is not in use.

In saying that cost accounting is non-historical it does not mean that it gives no attention to the past. But the records of the past are used mainly as a guide to the present and an indication of what may happen in the future. Though strictly speaking it is not a part of cost accounting, as such, budgeting and budgetary control are normally associated with cost accounting. Where there is a system of cost accounting budgets are likely to be found; where there is no cost system there are usually no budgets.

Concerned with the present and the future cost accounting pays great attention to the need for prompt reports — reports presented in time for prompt remedial action to be taken where necessary. Yearly or half-yearly financial statements presented two or three months after the end of the period are not good enough. The aim is monthly statements presented a few days after the close of the month. In fact standard costs, efficiency ratios and other devices give a continual day-by-day check on many aspects of the business.

The cost accountant realizes the importance of accuracy, but his aim is accuracy and speed. He is prepared to sacrifice a little accuracy in the interests of prompt reports, provided the scope for error is not great. He believes that in many circumstances a report 99% accurate today is better than a 100% accurate report several weeks hence. For example he will not delay the completion of a report merely because an invoice or creditor's statement is outstanding, if it is possible for him to make a reliable estimate of the amounts involved. To do otherwise is

to chase the shadow and lose the substance.

Cost accounting arose because financial accounting was not giving to management the information which it needed. In its development it paid a little more attention to the "why" rather than the "how" of recording transactions. The cost accountant classifies income and expenditure on a more logical basis; costs are accumulated as near as possible in relation to a department or cost centre responsible for incurring those costs. In some cases he dissects them according to the spheres of responsibility of those persons charged with controlling them. He does not hesitate to alter conventional classifications or methods of treating transactions if there is a need for better information.

The third special feature of cost accounting which we are considering is the fact that the cost accountant pays more attention to non-financial data. He knows that it may be just as important — perhaps more so — to pay attention to records which are in quantities rather than pounds shillings and pence. He realizes that it is futile to record every penny that goes through the petty cash and at the same time have no record — other than a periodical stocktaking — of stock which is many times more valuable. He knows too that control — particularly when its gets down the line to supervisors — can be better exercised when it is based on production units or efficiency ratios rather than on financial figures. He makes use of statistical studies and summaries to supplement his cost accounting records.

Perhaps it is the use of the "principle of exceptions" that is the most distinctive feature of the cost accountant. He believes that management is more vitally concerned with the one department or product that is not up to the mark rather than the ten where things are going more smoothly. In practice he makes use of standards as bases for comparisons. He knows that it is of little use to report that, e.g., wages amounted to a certain figure unless he also states what the figure should have been on some predetermined basis.

More important he knows that he must answer other questions such as these:

Why did the expense vary?

What departments, products, or processes were responsible for the increase?

Was the variation the result of changes in rates of wages paid or the fact that labour was inefficient?

All phases of income and expenditure are dealt with in this way. Similarly, attention can be given to the financial structure as shown by the balance sheet to see that as far as possible the financial position of the concern is in line with plans or requirements.

There is a tendency for the financial accountant to regard cost as a figure which is fixed and inflexible for all the various questions which involve a consideration of costs. But the cost accountant does not share this view. His view is that the cost figure to be taken into account differs according to the purpose for which the consideration is being made. For example, suppose the question is whether or not to open a new department or manufacture a new product.

Some of the costs of running the business will not be increased as a result of the proposed increase in production and sales. Some administrative costs, e.g., the salaries of managing directors and secretary will not be affected. Other costs may increase, but at much slower rate than the production and sales. So for this particular question those costs can be disregarded either wholly or in part. What is wanted is the figure for costs to be incurred as the

result of the proposal which would not be incurred otherwise. This will more effectively answer the vital question, i.e., will the business be better off, and if so by how much, as the result of producing and selling the new product. After all that is the paramount consideration.

So the cost accountant studies the nature of costs. He is interested in knowing which costs are, for practical purposes, relatively fixed and which vary more or less according to variations in production and sales. He knows that sometimes it is total costs which are required; at other times it may be marginal costs that are more suitable; for some questions he wants to know what are the sunk costs. "Differential cost and relative cost" have their uses.

One of the weaknesses in many accounting systems is the fact that too much dependence is placed on external records. For instance, a delay on the part of a creditor in sending invoices and statements is allowed to hold up the financial statements. The cost accountant wants the information as soon as the goods are received for his prices records, stock cards, and other things. He coordinates the purchase orders, goods received records, and creditors' invoices possibly cross-referencing them. This is another instance of paying attention to records other than purely financial books of account. Incidentally this guards against the omission of liabilities for which invoices have not been received at balancing time.

Where possible he records significant events when they actually happen. For instance, when stock goes from the store to production he records it by requisition or other means. Amounts of stock used are obtained directly from these requisitions. He does not rely on the roundabout way of having to take stock before knowing the cost of goods used during the period. He more correctly records the purchase of stock by debiting a stock account, rather than debit "purchases". The latter is a motley term which is neither an asset account nor an expense account.

Similarly he records the completion of finished goods by debit to finished goods stock and credit to work in process. He knows all the time — and not merely once or twice a year when stocktaking is done — the amount of materials, partly processed, and finished goods stock on hand.

The Approach to Integration

So far we have considered some practices of the cost accountant of the special features of cost accounting; we have seen how they differ from those of the financial accountant. Now we must see how this knowledge can be put to best use by integrating the concepts of financial accounting and cost accounting.

Here I must stress this point: integration is a matter of fundamental outlook or a philosophy, if you like, rather than an application of this system or that. The examples that follow are to illustrate how integration can be applied without in any way limiting the possibilities of integration. The examples are to show what has been done, to demonstrate that the idea of integration is not just a pretty theory.

Knowing that the cost accountant makes use of a more dynamic approach to accounting problems, we can examine the basic accounting for any organization to see how it can be improved. This can be done whether there is a cost accounting system in use or not. The place to start is the point at which something like an overall or bird's eye view of the business can be obtained. This is, of course, the yearly financial statements.

In Brisbane at a recent lecture delivered under the auspices of the Austra-

lian Institute of Management, Professor Mary E. Murphy referred to this point in reply to a question. She was asked what was the most important factor in achieving, in the United States, the high degree of integration of cost accounting and financial accounting. She replied that, in her opinion, one of the most important factors was the activities of the Securities Exchange Commission, which laid down certain minimum requirements for published financial statements of corporations whose shares were listed on national stock exchanges.

Impelled by the requirements of the Commission, accountants and executives in that country gave more attention to the financial statements. In improving the statements they gained a better insight into the activities of the company. This led them to study further what their accounting organization was giving them and what it should be able to give them. From the better picture thus obtained they adapted the accounting set up (and the cost accounting system if any) to give them the most useful information at the lowest possible cost.

Integration Where There is a Cost System

Now let us consider the case of a business where there is a cost accounting system already in force. It may be that the cost accounting system has been devised as part of the overall accounting system so that the problem of integration has been solved. But in most businesses this is not so. The cost system has usually been introduced in something of a piecemeal fashion. Often due to rapid expansion during the war years, it was not possible to give to the installation as much attention as is desirable. Whatever the cause, it is usual to find that no serious attempt at integration of the cost accounting and financial accounting has been made.

The broad picture of the ramifications of the financial accounting and cost accounting systems should be examined to see how they fit into the overall purpose of the accounting organization. The chart of accounts should be investigated if there is one. This is a useful aid for it is often easier to see from these charts and attached diagrams just how each section or each system works. Bearing in mind the overall purpose of the accounting organization we may ask the following questions:

1. Is the cost accounting system in use most suited to the business or should another concept of cost finding and control be used? For instance would marginal costing be more informative and less costly? Or should standard costs replace a job order system?
2. Is the process of cost finding carried too far? Are expenses apportioned and allocated to such a degree that the effort involved is not justified by the use made of the figures?
3. Does the financial accounting system duplicate some phases of the cost system? In other words is effort expended in dissecting expenditure in say the private ledger while the cost department at the same time is doing similar dissection as part of the detailed work of cost finding and control?
4. Is the process of reconciling the cost ledger and the private ledger such a large task that it seriously interferes with the other work of the cost department. (In a properly integrated system this problem of reconciliation almost disappears as both the "cost and financial" accounts are part of the one system).
5. Is it possible that the cost accountant and the financial accountant are both concentrating so much on the details of their respective tasks that

neither is providing the adequate and prompt information that is needed by management.

The answers to those questions will determine the best way of achieving integration. For instance, a slight expansion in the dissection in the private ledger may eliminate the need for a detailed cost ledger. (It may be that the effort involved in the detailed dissection is not warranted and yet the information in the private ledger may not be dissected in quite enough detail).

If detailed cost analysis is required it can be done without all the elaborate procedure conventionally associated with setting up a cost department. After all, subsidiary ledgers for debtors and creditors are controlled through control accounts in the private ledger without having to set up separate accounting departments. The aim should be to incorporate whatever cost analysis is necessary into the accounting system in something the same way as detailed information on debtors, creditors, and shareholders is handled. In some cases, a large part of the records of the cost department deal with technicalities of bringing entries into one set of books from another and reconciling balances — work that is made necessary only because the cost and financial records are not integrated.

Example of Integration

This problem was met by a secretary of a company which operated an abattoir and several retail butcher shops. On appointment he found that there was an elaborate system of cost analysis in force. The system brought to account all sorts of details but failed to provide reliable information for management at the time when it was needed. The secretary noticed that the records showed such details as the cost of producing a pound of steam; they showed the allocation of costs in an extremely detailed manner; but they did not provide an answer to important questions such as these:

> What price is needed to make the manufacture of small goods and other by-products profitable? What contribution towards fixed overhead and net profit are the retail shops making? Is it worth while to continue these shops or to expand with more shops? What was the result of the operations last month or last week?

He soon came to the conclusion that the system had been installed by someone whose enthusiasm for the technicalities of costing far exceeded his appreciation of what was needed by that particular company. So he abolished that system and worked out a new approach to the accounting requirements of the company.

From a study of the yearly financial statements and his knowledge of the industry, he ascertained what was the basic cost structure, and how the various costs were affected by variations in sales. The vital thing was to know what costs were incurred by killing a batch of stock, or producing by-products, or operating the retail shops which would not have been incurred if these things had not been done. He then had information on which wise buying and selling decisions could be based. To a large extent it is on such decisions that success in that business depends more than anything else.

The profits of the company were greatly increased by expansion of the by-products and retail shop operations. This had not been done previously because the accounts showed that they were operating at a loss — an artificial loss caused by debiting against such revenues a portion of expenses for administration and other fixed charges. Under the new integrated accounting system, this misleading impression was corrected. Realizing that these expenses would be in-

curred whether or not the by-products and retail shops were operated, the secretary wisely eliminated them from statements showing the results of these departments. The statements then showed that these departments were making a contribution to the net profits. Acting on these statements the secretary — who was later appointed manager — was able to increase net profits by expanding production and sales in these departments.

In the major departments of buying livestock from local and other areas for killing and sale to Sydney markets, killing stock for other operators, etc., the same approach was most useful. At times sale prices dropped or purchase price of stock rose so much that there was a very small margin. The accounting organization then gave accurate information as to the maximum buying price the company could offer and still make a profit. Thus in difficult times they were able to make small profits rather than run at a loss because of the works being idle — all because the right information was available.

Often visitors call on the manager and ask him about his accounting system, for the success of the company has earned it quite a reputation. After talking for a while they often say "Now, Mr. — could you tell us how much it costs to kill a pig?" With pencils poised they wait to write down his answer which they expect will run to three or four decimal places of a penny. But the pencil often drops from their hands in surprise when he replies: "As a matter of fact I don't know. We have never bothered to work it out; such a figure would be of no use to us. But I do know this: it costs money — in fact a lot of money — not to kill a pig." He then goes on to explain that so many factors enter into it — seasonal conditions, buying policy, the level of activity in the works, and that any figure calculated would not be a reliable indication. In any case it is not that figure but the marginal cost or the direct cost on which most decisions must be made.

This is an admirable illustration of the practical use of the marginal cost concept — a concept that is gradually receiving more consideration but which is not yet accepted by all cost accountants. But basically it goes further than that. It shows the advantages of taking a broad view of accounting requirements of deciding on what is needed and adapting the accounting set up accordingly — even if it means abandoning an elaborate system. The accounting system — including both what we generally term the cost accounting and financial accounting — must be "custom built" for the particular business.

That the allocation of costs to departments in detail was abandoned in this successful system is not a condemnation of normal costs accounting practices. Nor does it mean that students should forget all they have learnt or are learning about cost classification and distribution. Those techniques are essential for many purposes. But in using them accountants must not overlook the need for an integrated accounting set up and the advantages of using that cost concept which is most appropriate.

Integration Where There is No Cost System

Now let us turn to the vast number of businesses where there is no cost accounting system in use. Here again the approach is to take the financial statements as a starting point and see what are the overall requirements of the accounting organization. Then there is a better chance of making a wise decision on what improvements or changes are needed.

Too many businessmen and account-

ants are inclined to think that the modern developments of accounting (including cost accounting) are too advanced for them. They believe that such things are for larger firms or firms of a different type. If their business is not one that lends itself to the introduction of large scale cost accounting systems, they tend to make no use at all of latest developments. And yet the application of one or two of the concepts of cost accounting may be most useful.

An example of this is the use of budgets. The smallest business can profit from the use of budgeting. It is not difficult to set a simple budget based on previous financial statements, a study of the business and a knowledge of plans or hopes for the business. The budget may be expanded, or flexible budgets may be introduced gradually after the initial installation is working properly. Comparison of monthly trading results with the budget helps in keeping the business headed towards its goal. Control of expenditure is facilitated and efficiency can be improved. Incidentally budgets can be applied in almost every business though other techniques such as standard costs are not appropriate in every case.

There is this important point: the very setting of a budget draws attention to many aspects of the cost structure which otherwise can escape attention.

What many people overlook is the fact that the principles or concepts can be usefully applied though the normal detailed application may not be appropriate. Take stock as a case in point. Obviously a retail store cannot use stock cards and perpetual inventory which is suitable for manufacturers. But why not apply the principles even if some details have to be estimated? Purchases can be debited to a stock account — or possibly a separate stock account for each department — and sales credited to that account at cost by deducting from sales the estimated gross profit margin.

If this is done there is an indication of the trend of stock movements even though the figures may not be absolutely correct. This gives these benefits:

1. Daily stock balances — admittedly estimated — give a much better idea of the rate of stock turnover than annual stocktaking figures which are often not typical of the whole year.
2. Insurance requirements for stock can be calculated more readily. If the stock account is kept up to date every day there is useful information available in the event of a fire claim.

A step forward can be taken by recording some of the major variations from normal gross profit margins, e.g., sales "in the trade" at a discount, or sales in certain areas or to certain classes of customers, mark-downs for clearance sales etc. Again these are estimates but they give useful information. For instance, excessive mark-downs in clearance sales may highlight the cost of unwise buying, insufficient financial planning, or other factors which made the clearances necessary.

By concentration on major variations the recording is facilitated. Perhaps the use of different invoices for some types of sales may be convenient — this may already be done. Or the variation may be calculated by applying the percentage mark down to sales on the appropriate days. Physical stocktaking on which financial statements are based will reveal a difference between estimated stock and actual due to errors in estimating or other factors which it is impracticable to take into account. But the application of "the principle of exceptions" is beneficial no matter how limited the application may be.

Those interested in more details of this scheme may find them in my article "Control of Trading Stock" in the Jan-

uary 1949 issue of *The Chartered Accountant in Australia.*

Example of Integration Where There is No Cost System

Having considered the application of budgeting and stock control let us see how the organization with no costing system may make use of integrated accounting. I believe that the best illustration would be of a business which is small and normally regarded as not suited to the application of cost accounting, standard costs, and the like. So I shall briefly explain how I tackled this problem some years ago in a small public accounting practice — a "service type industry" where practically every job differs from the other and where there is none of the uniformity or mass production for which cost accounting including standard costs is regarded as normal.

In public accounting orthodox annual financial statements are of little use because:

1. They normally do not take into account work in progress. Differences between work in progress at the beginning and end of a period can distort results.
2. Prompt information is needed. To some extent the results of yesterday are the basis for setting today's fees. Up-to-date knowledge of costs and profit must be constantly available if the practice is to be as remunerative as it should be.

I approached the problem through a consideration of the yearly financial statements after putting them into vertical or narrative form. (This helps greatly in any business by making more apparent the basic features of the results). After due consideration it seemed that the answer lay in budgeting and a modified application of the standard cost concept.

The budget was based on an attempt to make the practice "worth while". This can be illustrated by assuming the following figures:

Desired minimum net profit is calculated like this:

	£
By carrying on the practice remuneration otherwise available as salary is sacrificed to the extent of, say	1000
Capital invested in the business, having regard to the risk involved should return, say, 8% on £1200	96
For accepting the somewhat higher degree of personal responsibility involved in public practice (audits etc.), say	200
Making a total of	£1296

Now let us suppose that a budget of expenditure on salaries, rent, stationery, and other expenses based on previous results and an allowance for expected salary increases, amounts to £1,204. This means that fees must return £2,500, i.e., desired net profit of £1,296 plus expenses that have to be recovered £1,204.

Next step is to turn to the earning capacity of the practice, i.e. the amount of productive time of the principal and staff available. From memoranda or time records and other factors it may be found that the principal who has to attend to supervision and staff training etc. can average on each day five hours productive time. The senior clerk can average six and three quarter hours per day and say one of the typists who spends part of her time on productive time (writing up books etc.) can average two hours per day. These times are based on a normal working week. Any extra work that the principal does should return him extra remuneration.

In a year of 52 weeks there are 260 working days. From this must be de-

ducted 15 days for three weeks annual holidays, 10 days for statutory holidays, an estimate of a week, i.e. five days for sickness or other absence, an estimate of seven days for honorary work based on commitments, and finally an allowance of 10 days for "idle capacity" caused by occasional shortages of work. These deductions aggregate 47 days, so from the 260 days are left 213 days on which calculations are based.

On this basis the productive times available are:

Principal: 213 days at 5 hours per day	= 1065 hours
Senior: 213 days at 6¾ hours per day	= 1438 hours
Typist: 213 days at 2 hours per day	= 426 hours

Taking into account qualifications, type of work being done, and other relevant factors, the time of the senior is estimated to be worth 25% of the principal's. Now to get a common factor, times can be simply converted to the equivalent of the principal's rate as under:

Principal's time	1065 hours
Senior's time in terms of principal's (60% of 1438)	869 hours
Typist's time in terms of principal's (25% of 426)	106 hours
Making total in terms of principal's time	2040 hours

Now if we divide the total recovery required in the budget by the hours available, we are getting somewhere. The sum of £2,500 divided by total hours of 2,040 gives a result of £1/4/6 per hour. That means that the available hours at that rate will just return the budget requirements of a net profit of £1,296.

To set a rate that cannot be obtained would be futile. Similarly it would be unwise to set a rate lower than that which can be reasonably obtained merely because that rate is the amount based on the budget. The scale of fees recommended by institutes, the standard of fees obtainable in the area, and other factors must be taken into account. As a result in the illustration the fee for the principal may be set not at £1/4/6 but at say £1/10/-; the senior's time would then be valued at 18/- per hour and the typist's time at 7/6. (Actually the rates are obviously much less than the rates that have to be charged in practice; they illustrate the principle but are not a true indication of actual charges).

As part of the system the time records are put on a sound basis. Principal and staff members record their time on daily time sheets or other record preferably balancing the productive time and total unproductive time with the number of hours worked each day. Clients' time cards are posted and balanced daily by a "short cut" method. It consists of balancing the movement on all operative cards with movement on control without bothering about the vast number of cards on which no entry was made on any particular day. (Time worked for clients is posted as a debit and time charged as a credit).

As each job is completed the principal (or senior in some cases), calculates the time shown on the card — in various columns for the various members — at the standard rates applicable to each. He may have to charge less than that figure because the fee is fixed or for policy or other considerations. He may be fortunate enough to be able to recover more than standard. The difference between fee charged and standard amount is shown on time charged slip as an over or under variation.

A summary of these variations gives

vital information. It highlights those fixed fee jobs such as audits which are uneconomic and shows what other jobs are not paying their way. More important, this information lessens the chances of the practitioner taking the easy way out by "letting it go" at the uneconomic amount charged in previous years. If such a system, or something like it, were employed universally a large part of accountants' worries over fees would disappear for their fees would be based mainly on facts rather than guesswork.

This further example of the principle of exceptions is incorporated into the monthly statements for the practice. Provided expense is controlled by constant supervision supported by comparisons with the budget, the success of the practice depends on:

1. The amount of productive work done.
2. The recovery of an adequate rate for work done.

So the result can be arrived at merely by calculating time on productive work done at standard rates plus or minus net over or under variations. Budgeted expenditure (with adjustments for those variations revealed by the review) deducted from this figure give net profit. So at half past nine on the morning of the first day of the month you can see the result for the previous month. More involved aspects such as absorbing holiday costs etc. are dealt with in my article "The Application of Managerial Accounting to Public Accounting" which appeared in the August 1950 issue of *The Australian Accountant.*

The practitioner may be wise to use the marginal cost concept in making decisions, but he must be careful that he does not take on more and more work at unremunerative fees. There are ethical as well as economic reasons for using the approach described above.

This brief description of the set-up in a public accounting practice shows how the standard cost concept or the principle of exceptions has been successfully applied in a somewhat novel form. Moreover, it has been applied to a type of business far removed from those in which you expect to see such techniques. To apply these and other useful concepts in many other new fields should not be beyond the ingenuity of accountants who are determined to provide information that will really help management or proprietors.

Conclusion

Perhaps it is worth while here to repeat the earlier statement that integration is a fundamental approach or a philosophy rather than an application of this or that particular system. Integration of cost accounting and financial accounting concepts is something that should interest every accountant — not merely those who are in the accounting or cost accounting sections of commercial or industrial concerns. Teachers of accounting are vitally interested. This is shown by the development of diploma courses in accounting which have been started recently at technical colleges. These courses emphasize the "oneness" of accounting rather than the separate applications of cost accounting and financial accounting. Commercial coaching colleges are fostering a broader application of the two major sections of accounting.

Public accountants have a vital part to play. In the past most public accountants, including some of those who could wield a great influence as directors of companies, have not concerned themselves with an examination of how cost accounting fits into the scheme of accounting. They have not encouraged their students to do the post-graduate

course in cost accounting. More unfortunately, some of them have made the illogical claim that the role of the commercial or industrial accountant is necessarily inferior to that of the public accountant. That claim is quite unfounded — a fact realized by practitioners who have learned a lot and helped their clients considerably by a cooperative approach to their colleagues in industry. The practitioner who appreciates and acknowledges the important role of the commercial accountant does not thereby weaken his own position. In fact he strengthens it by displaying a realistic attitude.

There is a point we must not forget. Despite the advances made by accounting in recent years, there are many businessmen and specialists who still think of the accountant as nothing more than a bookkeeper. They believe — or claim — that he is too impractical, too inflexible, that he cannot "see the wood for trees". So long as this attitude exists, we accountants cannot miss any chance to convince the business world of the value of accounting. In this task, there are many things which we must do. Not the least of these is to integrate the concepts of financial accounting and cost accounting.

NEW GOVERNOR-GENERAL'S AWARD FOR CHARTERED ACCOUNTANCY

His Excellency the Right Honourable Vincent Massey, C.H. has consented to the establishment of a Governor-General's Gold Medal award in chartered accountancy, it was announced on August 27 at the closing dinner of the C.I.C.A.'s annual meeting in Winnipeg. The award will be given for the first time in 1955 to the student attaining the highest marks in Canada in the uniform final examinations. It will replace the C.I.C.A. gold medal awarded each year since 1939 when uniform examinations for all Canada were first introduced.

Internal Sources of Capital

By A. W. Currie, B.A., B.Com., D.Com.Sc. (Harv.)
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Reinvestment is an advantageous means of financing

THE institutions which assist in capital formation are so numerous and so prominent in the community that one is apt to overlook other, and equally significant, sources. The fact is that both incorporated and unincorporated enterprises get a very large proportion of their capital internally. They reinvest profits or make better use of their existing funds and thus reduce their demands upon chartered banks, trade creditors, security markets, and so forth.

Reinvestment Exceeds External Financing

The aggregate of reinvested or plowed back profits of incorporated and unincorporated businesses is several times larger than the nominal value of the new securities which corporations sell to the public. The amount of reinvestment relative to the aggregate of all business investment cannot be stated precisely. The Bank of Canada reports that for the year 1953 personal saving which comprises saving by farmers, unincorporated businesses, and all other persons and organizations, except corporations and governments, totalled $1.5 billion. Retained corporate profits amounted to $700 million and depreciation allowances $2.3 billion. These three items together totalled $4.5 billion. The Bank's estimate of net new issues of the bonds and stocks of corporations was $517 million. In addition, both incorporated and unincorporated enterprises secured funds by means of bank loans, trade credit, installment purchases of machinery, implements and other equipment, the Industrial Development Bank, term loans from insurance companies, and mortgages from individuals and institutions. The total of all these sources, that is, the aggregate flow of funds into the fixed and working capital of Canadian business, must run to a huge figure but at all events reinvestment greatly exceeds the net sales of securities to the public at large.

Several factors account for the importance of reinvestment. Small and relatively unknown corporations do not attract purchasers of bonds and stocks and as a result investment bankers avoid small issues. Bankers feel their reputations are at stake in every issue which they sponsor and therefore they will not undertake to dispose of an issue until after they have made searching investigations. Generally they consider that it will not pay them to go to the expense

of analyzing issues of less than about $100,000. To be sure, a few investment bankers specialize in small issues and the over-the-counter market facilitates disposition to the public of the securities of corporations which, as a rule, are smaller and less conspicuous than those which are listed. Nevertheless, corporations with total capitalizations of less than a couple of hundred thousand dollars are definitely handicapped in selling securities to the public.

Why Reinvestment?

Concerns which are not incorporated include farms, most retail stores, service establishments such as barbering, shoe repairing and plumbing, and professional workers especially in medicine, dentistry, and law. This wide variety of personal enterprises get short term credit from commercial banks and other institutions or tap the pockets of friends or relatives for long term funds. Even so, the success of such concerns depends so much on the health and ability of one person; they have such limited lives, and their fixed assets often have so little value as security for a mortgage that they have no practical alternative to reinvestment if they wish to expand or to replace obsolete assets.

Though lack of alternative sources frequently explains why small enterprises reinvest, it does not account for the substantial amount of reinvestment by large corporations whose shares are listed on stock exchanges or which are well known to investors for other reasons. On the one hand it can be argued that these companies reinvest because of abnormal profits, because they make more money than they can conveniently pay out in dividends. On the other hand, it can be contended that they reinvest because they cannot secure funds elsewhere. For instance, in the years 1921-37, railroads in the United States added about $10 billion to the net value of their plant. Of this amount, 72% came from reinvested profits, 9% from the reduction of working capital, and only 19% from the sale of new securities. Obviously reinvestment is not possible if a business has no profits to reinvest. But under these conditions it would find difficulty in selling new securities to the public or borrowing from a bank. At any level of profits, the motives for reinvestment are, in fact, complicated, and the absolute amount of profits is but one of a number of factors influencing plow backs.

Taxation a Powerful Factor

To begin with, taxation is a powerful factor because corporations pay income tax and so do the individuals who receive interest and dividends. When a corporation borrows money it deducts the amount of interest it pays before it arrives at its own taxable income. Dividends, on the contrary, are paid out of what remains after the corporation has paid its income tax. Interest paid by corporations is taxed only once, that is, after it has been received by an individual. Dividends are, in effect, taxed twice, once before the corporation determines its net income available for dividends, and again after the dividend has found its way into the bank account of the investor. In an effort to remove this obvious injustice and to meet the complaint that our tax structure discourages venture capital, the federal government has started taxing the incomes of individuals from corporate dividends at lower rates than the incomes of individuals from other sources. There still remains, however, a considerable measure of double taxation of corporate profits. Such taxation can be largely evaded if a corporation never declares a dividend or if the dividends it does pay are much lower than its current earnings. Shareholders make an immediate saving

on income tax and they are given to understand that they have made another gain because the earnings which have been reinvested add to the book values and presumably to the market values of their shares. Furthermore, many shareholders believe that reinvested earnings or plow backs add to the corporation's surplus and so are available for the payment of dividends in poor years.

Burdens of New Issues Avoided

Then, too, shareholders are told by corporation executives that plow backs add to investment without the expense and trouble of selling new securities. The fees and commissions which would otherwise go to investment bankers are saved and the company and its shareholders are thereby benefited. Besides, common shareholders avoid the danger of dividing their control with new investors and of burdening their company with the restrictions which are frequently found in bond indentures, in bank loans, and occasionally even in preferred stock issues. The equity of present shareholders is not diluted in terms of either book or market value by the sale of new securities below the book or market value of existing shares. Nor is equity diluted because the company assumes a moral obligation to pay dividends on a larger number of shares than formerly. Finally, if a corporation were to pay out all its earnings as dividends, sooner or later it would have to approach existing shareholders to purchase more common stock. It would then have to appeal to these investors to put back into the company some of the money which, over the preceding few years, they had received in dividends. In other words, when a corporation reinvests net earnings which it might have legally paid out in dividends, it accomplishes the same objective as the payment of larger dividends and the subsequent or indeed the simultaneous sale of new securities. During the process the shareholders' position is substantially unchanged, and they and their corporation have been saved expense.

Professor A. W. Currie, B.A., B.Com., D.Com. Sc. (Harv.) is now associate professor of Commerce at the University of Toronto, and was formerly associate professor of Commerce at the University of British Columbia. He is author of the well-known book "Economic Geography of Canada".

Disadvantages of Plow Backs

On the other hand plow backs have been criticized on several grounds. Retained earnings are put into bricks and mortar, into machinery and land, into subsidiary companies, and so on. They are rarely invested in government bonds or other assets which are quickly convertible into cash. Since dividends must normally be paid in cash, a company which in a poor year has not earned its normal rate of dividends may lack the cash to pay dividends so that its surplus account, pretty and all as it looks on the balance sheet, is of little practical or immediate benefit to the shareholders.

Moreover, there is some evidence to show that the market values of securities do not rise in exact proportion to the amount of the plow backs. Specifically, the market price of the stock of a company which has reinvested $5 per share will probably rise by less than this amount. Apparently the annual rate of dividend has a more buoyant effect on the market price than the total earnings or the accumulated book value per share. Hence the investor who has not been paid in dividends all that the company has earned on his shares cannot, as a rule, recover all of the plow backs by selling his shares on the market. In any

case he may much prefer a larger annual dividend to a smaller one coupled with eventual capital appreciation of his securities. Small shareholders are likely to be particularly disgruntled if they have reason to believe that the individuals or group who dominate their concern deliberately and indefinitely defer paying dividends in order to minimize their own income tax. The rate of taxation on the dividend received by individuals with one or two shares is likely to be so small that they would be reasonably happy to pay the tax and have the rest of the dividend for current needs. But the rate of tax paid on additional income may be sufficient to discourage the declaration of dividends by a board of directors composed of large shareholders or of executives who are drawing handsome salaries from the company in question. Furthermore, some shareholders see that plow backs are not entirely free of taxation because of succession duties and, in the United States, of the capital gains tax.

Directors v. Shareholders

Sometimes investors dislike having their investment decisions made for them. Under the Dominion Companies Act dividends are declared by the directors who, therefore, have the power to decide what plow backs, if any, are to be made. If shareholders prefer a larger cash dividend than the directors are prepared to recommend, in law their only remedy is to replace the board. In practice, loud and persistent complaints by shareholders can often induce the board to "loosen up" on dividends. Theoretically investors ought to complain whenever they receive a lower net return on plow backs than they could have got if the corporation concerned had paid out all its earnings and the recipients of them, that is, the shareholders, had invested their dividends elsewhere. This theory is valid, but in practice shareholders have no real voice in the matter. The decision to reinvest is made by the directors. The fact that investors only occasionally complain of the treatment accorded them suggests that on balance they believe that plow backs work to their advantage rather than the reverse.

At all events corporations take advantage of the supineness of their shareholders to plow back profits. Some of the benefits of reinvestment to the corporation have already been touched on. Plow backs are a cheap and relatively painless means of getting capital and so, if its annual earnings are high, a corporation can easily add to its plant, machinery, or inventory. It expects to earn a regular profit on the additional capital but does not assume a legal obligation to pay bond interest nor the risk of being forced into bankruptcy should it fail to do so. It does not even morally oblige itself to pay dividends annually on a larger number of shares or even pay a larger dividend on the existing shares. Moreover, the corporation's present securities are strengthened because a larger equity or cushion is available in case of liquidation. Inasmuch as more assets are put behind the preferred and common stock, the market prices of present issues should rise, thereby helping the corporation to sell new securities at satisfactory prices.

A Bird in Hand

Of course, it is true that payment of regular annual dividends will also raise security prices and, other things being equal, make it easy for the corporation to raise new money from the public by selling bonds or stock, or to a lesser extent, improve its ability to borrow short term funds. The strength of this argument is weakened by the fact that corporation executives fear that other things will not remain equal, that when they come actually to sell securities the bond and stock markets may be depressed, that

investors may not value regularity of dividends as much as anticipated, or that the corporation's own profits may suddenly drop and investors turn sour on any new issue it may offer regardless of regular dividends in the past. Further, many corporations have now grown so large and diversified and the amount of their fixed capital per unit of output so huge, that they are virtually in continual need of more money. If they were to pay out all their earnings in dividends, they would have to offer new securities to the public every year or so. Experience shows that investors become progressively less enthusiastic about successive issues by the same company. Hence, when a company puts out one new issue after another, its cost of funds is likely to rise. In addition, the normal operations of the company's treasury are upset by these "annual sales" and each year the company runs the risk that through some miscalculation of its own executives or of its investment banker, its current issue cannot be absorbed or digested by the market. In short, corporations would rather invest money now when they have it, than pay it out and hope to get it back later. A bird in the hand is worth two in the bush, especially since modern industry is constantly in need of birds, that is, of capital.

Reinvestment is Socially Approved

Finally, though in theory corporations are controlled by their owners, the shareholders, in practice they are run by their senior officials and perhaps by one or more directors. These persons are interested chiefly in their own salaries, their own security, their reputations as able managers, and the preservation of the institution to which they are devoting their business lives. Of course, executives cannot ignore the shareholders any more than they can neglect workers, customers, or suppliers. Like Cabinet ministers, top management in business must weigh the interests of various groups and above all keep themselves in power. Reinvestment of earnings is one of the most satisfactory means whereby executives may perpetuate the institution for which they work. Plow backs provide resources for expansion, ought to protect against declines in earnings, and free the corporation from intensive and occasionally embarrassing analysis of its policies which takes place whenever it sells new issues through investment bankers. Reinvestment is praised by the business community: it is socially approved not by Emily Post or Duncan Hines, but by Bay Street, St. James Street, and Wall Street.

In view of all these advantages it is not surprising that plow backs are so important. They serve in part to offset the inadequacy of depreciation reserves brought about by inflation. Moreover, they have helped maintain high post-war prosperity. The economy may be badly hurt if business profitability declines or if boards of directors become unwilling promptly to reinvest in fixed assets or in inventory all net profits not paid out in dividends.

Recent Books

An Introduction to Cost Accountancy (Vol. 1), by R. Warwick Dobson, C.A., F.C.W.A.; published by Gee & Co. Ltd.; pp. 307; price 35/7

Commencing with a discussion of cost control, this book describes the elements of cost, the principles of their distribution, and the techniques of historical, standard, and marginal costing. Chapters on uniform costs, budgetary control, and cost control complete this volume.

Only a discussion of essentials is attempted, the forms and mechanics of cost recording and reporting being left to the remaining two volumes.

The use of sterling figures in the examples is an inconvenience to the Canadian student. This could have been avoided by the use of decimals for fractions of pounds instead of shillings and pence, as in the chapters on standard costs.

Of the elements of cost, the treatment of expense seems somewhat meagre. Chapter IV "Primary Costs — Expense" consists almost entirely of an exhaustive discussion of depreciation, with some examination of controversial items, such as interest and taxation. Other expenses are dealt with by a long list of examples at the beginning of the chapter and a short discussion of the inadequacy of their classification. This list is confusing as it contains items (such as income tax and dividend) which are not expenses in the accepted usage of the term and are not part of the distribution to cost.

The book follows the usual pattern of cost accounting texts, but one novel feature is the section on cost improvement in the final chapter. This integrates cost accounting with business management and shows how cost information may lead to improvement of methods.

F. R. CROCOMBE, C.A.
University of Toronto

Management Accounting (An outline of its nature and purpose); published by the Institute of Chartered Accountants in England and Wales; pp. 15; obtainable free from the Institute

A vast amount has been spoken and written in recent years on the subject of management accounting, and much of this has been worthwhile. However, sheer volume tends to cause confusion. The latest release in the field is the little booklet published by the Institute of Chartered Accountants in England and Wales in June. Small as it is physically, it covers the subject so satisfactorily and so concisely that it will certainly be classified as one of the finest contributions to the reference library on management accounting.

The booklet starts out with a brief discussion of the relationship of accounting to management and the part that figure information and reporting must necessarily play. Accounting information is then divided into two main classifications: accounting information for planning purposes and accounting information for control purposes.

Discussion on the nature of management planning, the use of accounting information for the formulation and presentation of the plan, and then the form and scope of accounting statements and reports for control of the plan is

handled in a broad manner so that principles alone are dealt with which are of general application in all types of business. The specific cases used for illustrative purposes go far to establish the key points in the minds of readers.

To all who are interested in this subject — whether from the professional or from the industrial viewpoint — this booklet will be most welcome as a clear, concise yet very thorough treatise applicable to every business in whatever country it may be located.

F. S. CAPON, C.A.
Montreal, Quebec

Fundamental Principles of Accounting, by C. A. Moyer and H. T. Scovill; published by John Wiley & Sons, Inc., New York; pp. 617 and index; price $6.00 U.S.

The emphasis in this elementary text is stated by the authors: "Those textbooks which would serve the beginner best should confine their attention to those topics which are basic, with proper supporting illustrative material, and should lay a solid foundation for later study in the various business areas, and for a career in business or government."

With this as an objective the authors have succeeded admirably. The basic material, as chosen, is carefully covered in a concise style and the problems are uniformly excellent. If the students do cover the text thoroughly, and the prescribed material, then undoubtedly they should acquire the necessary "accuracy in thought, action and speech" sought after by the authors. The headings of the first four chapters indicate the text's approach: "The nature and significance of accounting"; "The effect of transactions on the basic equation"; "Primary use of accounts"; "Proprietorship subdivided in the ledger". The text then proceeds in a logical progression up to the work sheet and adjustments. A review is given at the end of ten chapters which, for the beginning student, is so necessary to allow him a view of the related whole.

Noteworthy in the first part of the text is the authors' presentation of a detailed analysis of business transactions. The student is urged to make an inquisitive search into every transaction, to determine its roots and its effects. The authors have broken down this analysis into five steps which they apply repetitively to a series of varied business transactions.

It is in the second part of the text that this reviewer takes exception to the authors' selection of what is "basic". The problem in any introductory curriculum is to decide what to include and consequently what to exclude. This same task is given to the accountant in industry in his assessment of alternative courses of action. Each author must likewise question the fruitfulness of each of the various approaches to first year accounting. The authors announce their approach by stating that the last half of the text contains "a large amount of modern accounting and office procedure". Included in this are sections on sales and purchase forms and procedures, procedures for inventory taking, technique of finding errors, a chapter on payroll accounting, and a complete summarization of the voucher system. These undoubtedly are basic in the authors' minds. However, excluded are any references whatsoever to the cost of goods manufactured statement, to the peculiarities of the problems encountered in cost accounting. Even in the chapter on departmental distributions, where one might expect an expanded treatment of cost allocations, the student's attention is directed instead to the technique of booking sales and expenses.

Admittedly, many instructors will be pleased to see the emphasis given to the

figures behind the setting up of the closing inventory; also, it cannot be denied that the treatment of the voucher system is above other contemporary texts. However, this reviewer seriously questions the annual blossoming of new texts unless they make a more definite contribution to the textbook literature. Surely all the *basic* fundamentals, as established by the present authors, are treated adequately in the already published texts. The authors do have a contribution in their introductory chapters when they insistently make the student aware of the need for a detailed analysis of transactions; however, their content becomes ordinary in the latter part of their text. Moreover, this reviewer questions the place in introductory accounting of that method of teaching by which business systems are accentuated. Actually is not the study of systems and procedures a specialized study which can most profitably be undertaken *after* the student has a solid understanding of the accountant's purposes? Might it not even be advisable to exclude from the beginning text all references to systems, (including references to specialized books of original entry) and instead to include only a journal and a ledger, which is all that is necessary to record and summarize all the facts from the previously established detailed analysis? Even the technical procedure for closing accounts, which in the present text includes an elaboration of methods of ruling, is suspect if its teaching detracts the student's attention from the reason for the periodic summarization, matching, and reporting. The student himself must seriously question the space and time devoted to the laborious closing entries and the use of the profit and loss summary account when it is possible to obtain the same ends by other means. In short, what this reviewer would like to see, if there are to be yearly models in texts, is experimentation in these different approaches which might be able to offer more penetration into the accounting theory for the beginning student.

A closing word of praise: Included in the text is a rarity among introductory American texts, namely, a chapter on "single entry accounting". The usual American author ignores this outstanding method of testing the student's grasp of the effect of transactions upon the accounts.

W. J. McDougall, C.A.
Carleton College, Ottawa

The Evolution of the Science of Book-keeping, by H. J. Eldridge and revised by Leonard Frankland: published by Gee & Co. (Pub.) Ltd., London; pp. 70; price 3/6

This little book summarizes and illustrates the main developments in record-keeping in the last four thousand years.

It is a British publication — note the hyphen in "Book-keeping" — from the material first assembled for a lantern slide lecture many years ago. The result is a "capsule" presentation, each capsule presumably having been illustrated by a different picture flashed on the screen. This presentation is unusual, but makes for easy reference and for a quick summary of the various developments attributable to this person or that group. It is the kind of summary of the development of accounting — with names, dates and enough detail for a modern audience — which could be used by a practising accountant if he is ever called upon to speak in public and make any brief references to the history of his science. Short interesting quotations from various authors through the years are included with some quips and comments which were originally used, no doubt, by the lantern lecturer.

The emphasis is on "book-keeping" and this appears to be distinct from "accounting" and certainly from such things

as auditing or systems or any such modern specialized field. It would have been better had the author stopped at about 1900 and not tried to mention mechanized accounting and other developments. The result of trying to mention in limited space all who contributed to the evolution of bookkeeping even during the late 19th century makes the last third of the book resemble a bibliography more than anything else.

The first two-thirds of the book, however, is an interesting and worthwhile reference for the accountant's bookshelf.

A. D. McTavish, C.A.
Edmonton, Alberta

A History of the Chartered Accountants of Scotland from the earliest times to 1954; published by Institute of Chartered Accountants of Scotland; pp. 183; price 12/6

This is "an account of the history of the chartered accountants of Scotland from the beginnings of the profession in the latter part of the seventeenth century until the present time". The history of early Scottish accountancy can be traced to the passing of the Bankruptcy Statutes in 1696 when it became the practice of the Court to call on an accountant "to consider the whole accompts and to state the points in controversy and to prepare the minutes for the Lord Ordinary". The loss of the American Colonies and the upheavals caused by the French Revolution were responsible for a large number of bankruptcies. By the middle of the nineteenth century the profession of accountant was well established in the principal cities of Scotland. The scene was set for the formation of the three Scottish societies which continued their separate existence for nearly 90 years until the Institute of Chartered Accountants of Scotland was formed in 1951. The Society of Accountants in Edinburgh was incorporated by Royal Charter in October 1854. The Institute of Accountants and Actuaries in Glasgow was granted a Royal Warrant in the following year, and in 1867 recognition was given to the Society of Accountants in Aberdeen.

In the financial hurly-burly of the industrial revolution bankruptcy proceedings formed a major part of the work of the profession; it was easy to start in business and, in the keen competitive spirit of the age, easier still to fail. Following the First World War the great increase in the complexity of the country's tax structure brought many small firms within the chartered accountant's orbit. It also increased his value to larger organizations, many of which were in need of complete reorganization of their financial affairs. In the 1920's and early 1930's the boom and subsequent depression inevitably brought grist to the mills of chartered accountancy. Similarly, the Second World War with its additions and extensions to the tax structure still further increased the demand for the profession's services.

To a good book the authors, who remain anonymous, add a bonus of 34 photographs, some of them period pieces and all of interest, they complement this well assembled story of the proud record of the Scottish chartered accountants whose Institute, the oldest accountancy body in the world, celebrates this year its centenary.

Renny Englebert
Toronto, Ontario

Professional Notes

ALBERTA

Geddes, Knebel & Beaton, Chartered Accountants, announce the removal of their offices to 204 Imperial Bank Bldg., Edmonton.

* * *

Mr J. L. Kergan, F.C.A. has been elected a fellow of the Institute of Chartered Accountants of Alberta.

BRITISH COLUMBIA

At the 49th annual meeting of the Institute of Chartered Accountants of British Columbia three Vancouver chartered accountants were elected Fellows of the Institute. They are Messrs Robert Bell, F.C.A., Alexander A. Fairnie, F.C.A., and William R. Watson, F.C.A.

* * *

B.C. Students' Society

This society reports a very active spring and early summer. On May 21 their annual spring dance took place in the Aztec Room of the Hotel Georgia, music for dancing being supplied by Al McMillan. Then on June 11 the annual golf tournament for students in the Greater Vancouver area was held at the Peace Portal Golf Club, situated on the Canada-U.S.A. border. A banquet and presentation of prizes followed the tournament.

In its educational activities the society made arrangements with the British Columbia Electric Company for a tour of the latter's accounting department on May 6. The officials of this company presented a very instructive and well-organized tour placing special emphasis on the uses and advantages of machine accounting.

* * *

Briggs, Young, Peers & Co., Chartered Accountants, and Maas, Holman & Co., Chartered Accountants, announce the amalgamation of their practices. Their combined practices will be carried on under the firm name of Briggs, Young, Peers & Co., Chartered Accountants, with offices at Ste. 4, 1161 Melville St., Vancouver, and at 705 W. 2nd St., North Vancouver. Mr. Keith S. Holman, C.A. will be the resident partner of the North Vancouver office.

* * *

Rickard, Crawford & Co., Chartered Accountants, Williams Lake, B.C. announce the admission to partnership of Mr Robert A. Court, C.A.

MANITOBA

Mr David A. Gilman, C.A. announces the admission to partnership of Mr Ben T. Burke, C.A. and the association with them of Mr. Bert Newman, B.A., C.A. Henceforth practice of their profession will be conducted under the firm name of Gilman, Burke, Newman & Co., Chartered Accountants, with offices in the Trans-Canada Bldg., 325 Main St., Winnipeg.

NEW BRUNSWICK

Mr E. R. Fowler, C.A., announces the removal of his office to 329 St. George St., Moncton.

ONTARIO

James M. Dunwoody & Co., Chartered Accountants, 330 Bay St., Toronto, announce the admission to partnership of Messrs Alan G. Bowers, B.Com., C.A., William V. Curran, C.A., C. Bruce Magee, C.A., and Peter J. M. Quarmby, C.A. Practice of the profession will continue under the same name with offices at Toronto, Welland, and Oakville.

* * *

Messrs Earl G. Robinson, C.A. and Patrick J. Sullivan, B.Com., C.A. announce the formation of a partnership for the practice of their profession under the firm name of Halladay, Robinson & Co., Chartered Accountants, with offices at Ste. 14, New Bond Bldg., Guelph, Ontario and at Ste. 1606, 330 Bay St., Toronto.

H. T. Jamieson, LeMay & Co., Chartered Accountants, Royal Bank Bldg., Toronto, announce the admission to partnership of Mr R. E. McAfee, B.Com., C.A.

QUEBEC

Quebec Institute

The 74th annual meeting of the Institute of Chartered Acccountants of Quebec was held on June 14 in the Royal Bank of Canada, St. James Street, Montreal. It was followed by the Institute's annual golf tournament and dinner.

* * *

Mr C. Douglas Mellor, B.Com., C.A. has been appointed executive secretary of the Institute of Chartered Accountants of Quebec. Prior to this appointment Mr Mellor was a senior partner of Sumner, Mellor & Co., Chartered Accountants, Montreal. He is a graduate of McGill university and has been on the teaching staff of McGill's evening accountancy course since 1941. Mrs Ethel Dixon continues as assistant secretary of the Institute.

SASKATCHEWAN

Two members of the Saskatchewan Institute were elected Fellows at the Institute's annual meeting held on June 26 in Moose Jaw. They are Messrs P. B. Keffer, F.C.A. and J. M. Moynes, F.C.A.

News of Our Members

Union Gas Company of Canada Limited, Chatham, Ontario, announce that Mr Fred R. Palin, C.A. (Ont.) has been appointed assistant general manager and Mr H. J. Denison, C.A. has been appointed comptroller.

* * *

Mr Eli Godel, C.A. (Que.), won the Quebec Amateur Golf Championship in August.

Mr Thomas Van Zuiden, C.A. (Ont.), has been appointed chief accountant of Dominion Foundries & Steel Ltd., Hamilton, Ontario.

* * *

Mr Alex G. Rankin, C.A. (Ont.), is the new president of the Canadian Association of University Business Officers.

Obituaries

Rex Birdsall LeCocq

The Institute of Chartered Accountants of Ontario announces with regret the sudden death of Rex Birdsall LeCocq of Fort William, on Saturday, July 24. Mr. LeCocq, who was in his 42nd year, drowned accidentally while fishing at Loon Harbour along the North shore of Lake Superior.

He was born and educated in Fort William and graduated in Commerce from Dalhousie University in 1933. He became a member of the Ontario Institute in 1950 and soon after became a partner in the firm of Crawford, LeCocq & Company. Mr. LeCocq was one of the original organizers of the Fort William Branch of the Ontario Society of Industrial & Cost Accountants and was treasurer of the Fort William Progressive Conservative Association.

To his wife and young family the members of the Institute extend sincere sympathy.

Harry Ernest Clayton

The Institute of Chartered Accountants of Ontario announces with regret the death of Harry Ernest Clayton at Toronto, on July 7, 1954, at the early age of 39. He had been ill for a year.

Mr. Clayton was born and educated in Toronto and became a chartered accountant in 1942. During the Second World War he was district supervisor of automotive contracts for the Treasury Costs Division of the Canadian Government at Ottawa. For the past nine years he had been comptroller and secretary for Tip Top Tailors. He was a past president of the Toronto Chapter of the Society of Industrial & Cost Accountants of Ontario, a member of the Board of Trade, All Saints Anglican Church, Kingsway, and Occident Masonic Lodge.

To his wife and family the members of the Institute extend their sincere sympathy.

Accounting Research

By Gertrude Mulcahy, B.A., C.A.
The C.I.C.A. Research Department

STATEMENT OF PROFIT AND LOSS

READERS of financial reports are interested in being able to determine the relative earning power of enterprises. To arrive at a fair conclusion they must take into account the information contained in both the statement of profit and loss and the balance sheet. Neither of these statements, by itself, provides a full picture, and neither can be ignored in forming a judgment of the results of operations. The balance sheet presents the financial position as at a given date, and the statement of profit and loss provides an historical record of operations, the results of which are incorporated in the balance sheet.

Until about the time of the Great Depression of the 1930's, the tendency was to emphasize the balance sheet as the focal point of the annual report. The more recent trend has been to recognize the statement of profit and loss as vital to an integral presentation of the financial picture. To meet this development the Committee on Accounting and Auditing Research of the Canadian Institute of Chartered Accountants have recommended, in Bulletin No. 6, that the auditor's responsibilities be expanded to include the fairness of presentation of the statement of profit and loss as well as the balance sheet. Before the enactment of the Corporations Act, 1953 (Ontario), none of the governing statutes specifically mentioned a report by the auditor on the statement of profit and loss, but it appears that accountants in this country are for the most part in agreement with the recommendations set out in Bulletin No. 6. In 72% of the 1952 financial reports analyzed, the auditor's report included the statement of profit and loss within the scope of the opinion (67% in 1951).

To present a fair picture it is imperative not only that the information disclosed be correct but also that the information be presented in such a manner that it is readily discernible. It is rather unfortunate that sometimes the picture is clouded unintentionally by loose form and terminology. However, in the course of reviewing the financial statements included in the annual reports for the years 1949, 1950, 1951, and 1952, it is apparent that management and accountants in this country are increasingly aware of their responsibilities for a clear and readily understandable presentation of facts. On the other hand, it is rather discouraging to note that in some cases the requirements of the governing statutes appear to have been accepted as the "standards of disclosure" rather than the "minimum standards of disclosure".

Canadian companies employ a wide

variety of methods of setting out their operating results. Variety may be commended if the precepts of consistency and comparability are honoured, and provided that the various items are arranged and described so as to give a clear view of the operations of the business.

Title of Statement

From figure 1, it is apparent that the majority of Canadian companies continue to use the words "Profit and loss" in designating the statement reflecting their operating history. The miscellaneous category in figure 1 includes such titles as: statement of earnings, statement of income and expenses, summary of earnings, and statement of operations.

Form of Statement

The majority of the annual reports analyzed included separate statements of profit and loss and of surplus. However, in 26% of the 1952 annual reports, (26% in 1951, 35% in 1950, and 34% in 1949) the statements of profit and loss and of surplus were combined in one statement (as in example 5).

The continued prominence of the "Single Step" and "Single Step and Taxes" form of statement presentation (examples 3 and 4) was evidenced in the analysis of the 1952 financial reports, although many companies continued to use the ordinary form of profit and loss statements (example 2).

Some of the details presented in 20 of the statements tended to confuse rather than to clarify the results (example 1). On the other hand, 38 were considered deficient in the details presented. The extreme case of this latter type is set out in example 5.

Examples — Good and Bad

Excerpts from published financial statements of 1952 have been selected as examples to illustrate the various forms, titles, and terminology used on the statements of profit and loss and to give evidence of the merits of clear content and presentation.

A reader of example 1 certainly should carry a chart and compass. By the time he has worked his way through the mass of additions, subtractions, and sub-totals he will be so confused that it will be rather difficult to get back on the right course — namely the determination of factors contributing to the net results of operations. One might well ask: What

Example 1

Terminology used in Titles of Statement of Profit and Loss

1952	1951	1950	1949		
58%	60%	57%	54%	—	Profit and loss
14%	14%	19%	18%	—	Profit and loss and (earned) surplus
8%	8%	8%	10%	—	Income and expenditures
2%	2%	2%	2%	—	Income and expenditures and (earned) surplus
4%	4%	3%	3%	—	Income
2%	2%	1%	—	—	Profit and loss and earnings retained and used in the business
12%	10%	10%	13%	—	Miscellaneous
100%	100%	100%	100%		

does the sub-total $316,431 represent? Why is it deemed necessary to set out the various component figures of the current provision for depreciation? What is the significance of the presentation as a separate item of the provision for audit fee $4,000? The one redeeming feature of the statement, namely its preparation on a comparative basis, is of little consequence in this case.

In complete contrast is example 2 which arranges the items under descriptive headings and provides the reader with a readily understandable picture of the operating results. Although this statement was not prepared on a comparative basis, the directors' report included a number of charts which clearly indicated the current trend of the company's earnings. The statement arrangement typifies the "ordinary form" of statement of profit and loss.

Example 3 portrays what is called the "Single Step" form of statement presentation. The method of listing the various operating expenses in the description of the profits from operations is used by some companies to meet the requirement of disclosure set out by the governing statute or to disclose items which are felt to be of significance. Included in the financial report of this company were charts setting out a comparison of sales for ten years, the distribution of the current income dollar, and a ten-year comparison of the distribution of earnings.

The statement of profit and loss set out in example 4 limits its detail to the minimum requirements of the Companies Act (Canada) without taking into account additional information which might be of interest to the reader.

In addition, the use of the term "*Net profit* from operations" in the first line of the statement and of the term "*Net operating profit*" in the last line would cause some doubt in the reader's mind as to what was considered by management to be the net profit from the current operations. The significance of reporting cents when dealing with a figure of $134,843 is questionable.

The company whose statement of profit and loss is set out in example 5 does not help the readers of their annual reports to determine the components of the net profit for the period. It is impossible for the reader to arrive at any informed conclusion as to the trend in the earning power of this particular company. This concern was incorporated under the Ontario Companies Act which did not set out specific items to be shown in the statement of profit and loss. One cannot help but wonder how such a statement could ever be thought to reflect good accounting principles.

In example 6 the management set out, as footnotes, the amounts attributable to the various operating expenses which by reason of their nature or significance were to be disclosed.

A reader who is not familiar with accounting principles might be confused by the presentation of the segregated figure for "Net sales to customers" at the beginning of the statement. In his ignorance he might spend considerable time trying to balance the net profit with this figure. Nevertheless, the disclosure is informative.

The form and content of example 7 could be recommended for use by those companies which consider it desirable to set out, in their statements of profit and loss, details as to sales, cost of sales, and expenses, over and above the legal requirements.

EXCERPTS FROM PUBLISHED FINANCIAL STATEMENTS — 1952

STATEMENT OF PROFIT AND LOSS

Example 1

STATEMENT OF PROFIT AND LOSS
For the Year ended March 31, 1952

	1952	1951
Gross profit	$3,222,213	$3,180,460
Deduct:		
Selling and distribution expenses	1,760,436	1,538,165
General and administration expenses	1,088,560	1,056,483
Other charges less other income	12,305	51,802
	$2,861,301	$2,542,846
Trading profit	$ 360,912	$ 637,614
Deduct:		
Interest expense — . . . . . Limited	$ 47,857	$ 47,856
Interest income	3,376	6,445
	$ 44,481	$ 41,411
	$ 316,431	$ 596,203
Deduct:		
Provision for depreciation		
Freehold properties	$ 16,379	$ 16,900
Leasehold properties	1,703	$ 1,703
Fixtures, equipment and vehicles	14,959	19,068
Provision for audit fee	4,000	7,000
Interest expense —		
Bonds	10,125	11,625
Bank loan and overdraft	83,107	84,301
	$ 130,273	$ 140,597
	$ 186,158	$ 455,606
Deduct:		
Provision for income taxes	98,000	207,000
Profit for the year	$ 88,158	$ 248,606

Note: General and administrative expenses include:

Executive salaries	$ 37,226	$ 35,626
Directors' fees	5,000	5,000
Legal fees	5,260	2,500

Example 2

CONSOLIDATED STATEMENT OF INCOME AND EXPENSES

Year ended August 31, 1952

NET SALES		$306,998,430
COST OF GOODS SOLD		238,403,387
		$ 68,595,043
EXPENSES:		
Selling and general expenses	$33,313,684	
Salaries of executive officers of parent company	363,740	
Fees of directors of parent company for services as such	19,884	
Legal fees	78,532	
Debenture interest	112,640	
Interest on bank loans	39,938	
Provision for depreciation of buildings, plant and equipment	2,169,851	
Other charges	91,555	36,189,824
		$ 32,405,219
OTHER INCOME:		
Dividends and interest on investments	453,785	
Storage, elevation, purchase discounts, etc	785,763	
Foreign exchange adjustments	72,716	1,312,264
		$ 33,717,483
PROVISION FOR INCOME TAXES		18,043,323
NET EARNINGS		$ 15,674,160

Example 3

CONSOLIDATED STATEMENT OF PROFIT AND LOSS ACCOUNT

For the Year ended 31st December 1952

Profit from operations for the year ended 31st December, 1952 after deducting Depreciation and Depletion $4,241,107, Salaries of Executive Officers $177,080, Payments under Contributory Pension Plan $692,135, Legal Fees $19,712 and Directors' Fees $10,050		$9,585,530
Income from Investments		115,313
Royalties		110,878
Deduct:		9,811,721
Interest on Funded Debt	$ 787,089	
Amount written off Patent and Research Expenditures	61,621	
Provision for Income Taxes	4,950,000	
		5,798,710
Net Profit		4,013,011
Deduct in respect of Minority Shareholders of .... Company, Limited:		
Dividends	131,200	
Equity in 1952 undistributed profits	54,929	186,129
Balance for the year ended 31st December, 1952 transferred to Earned Surplus		$3,826,882

Example 4

Condensed Profit and Loss Statement

	1952	1951
Net Profit from operations (after deducting Executive Salaries $10,000, Depreciation $19,779.55, Directors' Fees $475.00, Legal Fees $263.00 and Interest on Debentures $47,556.46)	$134,843.76	$206,626.55
Deduct:		
Provision for Income Taxes	66,000.00	103,750.00
Net Operating Profit for the year, transferred to Surplus	$ 68,843.76	$102,876.55

Example 5

Statement of Earned Surplus for the Year Ended 31st March 1952

(*Earnings Retained for Use in the Business*)

Balance — 31st March, 1951			$1,652,448.61
Net Profit for the year—			
Net profit from operations, after providing for all expenses including depreciation and income taxes		$432,962.02	
Revenue from investments, including dividends from wholly-owned subsidiary company		61,120.83	
			494,082.85
Net Profit from sales of securities			52,634.55
			2,199,166.01
Dividends		269,100.00	
Appropriations for reserves —			
Inventories	$35,000.00		
Marketable securities	52,000.00	87,000.00	356,100.00
Balance — 31st March, 1952			$1,843,066.01

Example 6

Statement of Consolidated Profit and Loss

For the Years ended December 31, 1952 and 1951

	1952	1951
Net Sales to Customers	$190,214,161	$180,789,204
Income from Operations after deducting depreciation and all expenses of manufacturing, selling and administration	$ 13,879,864	$ 13,794,128
Add		
Net income from securities and profit from sales	328,684	485,823
	14,208,548	14,279,951
Deduct		
Interest on funded debt	1,045,090	980,709
Net Profit for the Year	$ 13,163,458	$ 13,299,242

The following amounts have been charged before determining the profit for the year:

Provision for depreciation	$ 17,548,731	$ 12,474,792
Provision for income taxes	10,647,777	16,455,196
Contribution to Pension Trust Fund	1,500,000	1,400,000
Directors' fees	18,000	18,000
Remuneration of executive officers	331,900	331,142
Legal expenses	30,557	14,107

Example 7

STATEMENT OF INCOME AND EXPENDITURE

	For the years ended 22 March 1952[1]	17 March 1951
SALES	$99,781,680	$74,184,854
COST OF GOODS SOLD:		
Opening inventory	4,468,358	3,569,847
Add: Cost of Merchandise and Supplies	84,937,560	63,182,655
	89,405,918	66,752,502
Deduct: Closing Inventory	5,294,106	4,468,358
Cost of goods sold	84,111,812	62,284,144
EXPENSES:		
Employees' salaries and benefits	8,170,624	6,132,477
Rent, light, heat, telephone, laundry, repairs and maintenance	1,815,613	1,220,454
Other expenses, including advertising	803,987	711,593
Executive remuneration	345,358	299,832
Depreciation on buildings and equipment	416,971	294,137
Business taxes, licences and insurance	243,688	180,391
Directors' fees	11,500	12,000
Legal fees	2,529	4,957
Total expenses	11,810,270	8,855,841
Deduct: Interest earned	3,878	28,229
Total Cost of Goods Sold and Expenses	95,918,204	71,111,756
	3,863,476	3,073,098
INCOME TAXES	2,060,000	1,350,000
NET PROFIT	$ 1,803,476	$ 1,723,098

[1] 53 weeks

Practitioners' Forum

Conducted by Geoffrey H. Ward, C.A.

FEES — HOW MUCH TO CHARGE?

IN the May 1953 issue of *The Journal of Accountancy* Jules Backman writes on "factors affecting fee setting in the several professions". Mr Backman lists seven factors which determine fees charged. These are:

1. Cost of service rendered: (a) expenses incurred — office expense, capital equipment, etc. (b) time involved.
2. Ability to pay.
3. Value of service rendered: (a) amount of money involved, (b) savings to client, (c) convenience to client, (d) success or failure, (e) establishment of precedent — new or novel questions.
4. Customary fees.
5. Casual or established client.
6. Fixed fee or contingency fee.
7. Legal limitations.

Mr Backman also makes many other comments of general interest. He thinks that two basic economic features of the various professions are, first, product or service differentiation and, secondly, fewness of sellers. Non-price factors are of predominant importance in competition rather than price. A fundamental economic characteristic of fees in the various professions is their inflexibility. Fees remain stable for many years. Once established they tend to remain at the same level regardless of the changes in the cost of living and other pertinent factors.

Professional fees are characterized by widespread price discrimination, that is, the practitioner may charge different clients widely varying fees for what is essentially the same service. But quoting a high fee because of the tendency on the part of some clients to haggle about the fee does not seem to be a wise approach for professional men.

The effective range for professional fees is found between the cost of service as a minimum and the ability to pay and the value of the service as a maximum. There are two basic expense items or costs: the first is the out-of-pocket expenses and the other is the time spent. Determination of the hourly rate for partners is difficult but the following factors might be considered: reputation, experience, competency, prestige, personality, age. Generally it is poor practice to undercharge. Where time is an important factor it should be recognized that not all time is of equal value.

Charging according to the ability to

This department appears bi-monthly in *The Canadian Chartered Accountant*

pay can be justified on various grounds as this practice is followed by the legal, medical, and dental professions. However, in Mr Backman's opinion willingness to pay is a factor that sets a limit lower than ability to pay.

When considering the value of the services rendered, the amount of money involved is a factor. Extra compensation for convenience is illustrated by doctors who charge more for a house visit than an office visit. In accounting the novelty or difficulty of a question may justify a larger fee. Apparently, the idea of customary fees is developed more by lawyers and doctors than by accountants, as most bar associations and medical associations have schedules of suggested fees. The essential purpose of these schedules is to discourage competitive price-cutting and to check the practice some laymen have of shopping around among lawyers, telling each what the other said he would charge and thus trying to get the work done below the price it ought to be done for.

On the basis of fairness, claims Mr Backman, it would appear that the casual client should be charged more than an established client for a special service such as the preparation of income tax returns. This is because the regular client ensures the practitioner of a steady volume and has helped to build the practitioner's accumulation of research material and experience. However, other factors such as the desire for future business and the tendency to consider the time factor act as an offset.

The question of fixed or contingency fees is not a major problem with accountants, as contingency fees are considered unethical and work is not done on that basis.

Record keeping is important — while it is a nuisance it pays off. When billing the client it is often better to send the bill in instalments, that is, five bills of $100 each may be more readily accepted and paid by the client than one bill for $500. Another question which Mr. Backman deals with is the amount of detail to be shown on the bill. Generally speaking he says that it is preferable not to itemize the charges in detail. Show one figure for services and another for out-of-pocket expenses and keep the amount for services in round figures. However, it is usually wise to summarize in some detail the work accomplished, with unusual work being given special attention.

Accountants have found that clear discussions in advance with clients as to what fees will be and the reasons for them, particularly when some additional charge is necessary, have eliminated misunderstandings over fees.

So much for a broad discussion on this subject. Now here are some specific pungent comments sent in by a local practitioner in a smaller community which I trust you will find interesting:—

"I believe one of the risks in the accounting profession is the ability to set a fee and, in the years to come, I should think the small practitioner would be better off to make a yearly arrangement with his client in advance. In my opinion this is practicable in most instances and, therefore, I would prefer to approach it on that level. The special cases have too many complications to put down in writing, and I think these special cases have to be ironed out individually between the auditor and his client. As a general rule, however, I think a frank presentation of minimum costs should be discussed with a client before any work is started and as soon as the time involved can be estimated with any degree of accuracy, then an over-all fee should be arranged. Leaving it too late is most unsatisfactory.

"No matter how we may theorize, there is no point to our doing work that we cannot be paid for. The main ingredients of our "Shelf Product" are:

1. Time of partners.
2. Time of audit staff.
3. Time of stenographic staff.
4. Overhead.

"Under present day conditions, in a small community where partners are required to contribute much of their time to community efforts, we have found that the "Cash Hours" of partners work out to somewhere between 1,000 to 1,200 per year. We try to set our charge-out rate based on these hours to pay the partners a reasonable salary. If we cannot recover a reasonable salary, what is the point of staying in business?

"Under present-day conditions we find that the annual "Cash Hours" of our audit staff rest somewhere between 1,500 and 1,700, and of our stenographic staff somewhere between 700 and 1,000. Experience also shows that overhead works out to approximately the same yearly total as staff salaries (excluding partners).

"Simple arithmetic, therefore, indicates that unless you can recover at least double the rate worked out on the above "Cash Hours", there is no point in taking on work for a client.

"Education is a slow process, and we have found, generally speaking, that when the matter is frankly discussed with a client we do not lose very many clients because of high fees.

"When one thinks of the $2.50 and $3.00 rate that is being charged in certain unskilled trades, I do not think our profession should apologize for the hourly rates which it must charge in order to make a respectable living in a profession in which we have spent many years of study and research for the ultimate benefit of our clients."

From an editorial in *The New York Certified Public Accountant* of January 1953: "Certainly there seems no reason to keep fees down to what may be considered a competitive level in a period of heavy demand for accounting services. In professional practice volume alone has little merit. The practitioner who is known for the high quality of his services has nothing to fear in the future even if a buyers' market should develop . . . .

"There may be a false sense of security in just being busy. Quite a few C.P.A.'s think it is time to review the whole question of fees, staff salaries, and standards of performance in their own offices."

That was 18 months ago but I feel that the thought expressed is still sound. Don't you agree?

To Our Contemporary

I NOTE with interest "The Practitioners Forum — a new department to furnish practical help in managing an accounting practice" which first appeared in the June 1954 issue of *The Journal of Accountancy* published by the American Institute of Accountants. Welcome, cousin.

Loans to Veterans

SOME recent graduates who are veterans may not be aware of the existence of the Veterans' Business and Professional Loans Act 1946. This provides assistance to veterans who wish to obtain a loan from a bank for various purposes including: (1) the purchase of a business, including the purchase of an interest in an existing partnership and the advance of capital for a new partnership. However, the partnership business must be the main occupation of the veteran and he must participate actively in the business; (2) the purchase or repair of machinery, tools, instruments or other equipment for his business; (3) various other purposes that may be deemed to benefit his business, including the payment by a veteran into the funds of a partnership of which he is a partner.

Some of the conditions of these loans

are: maximum amount $3,000; principal may not exceed 2/3 of the proposed total expenditure; maximum payback period ten years; interest 5%. These loans are guaranteed by the federal government. The loan must be made within a period of ten years from January 1, 1945 or the date of the veteran's discharge whichever is the later. So the time is rapidly running out during which these loans may be obtained.

I mention this Act as perhaps not too many veterans know about it. This may be the answer for someone who wants to get established but has a problem because of lack of capital. However, you will have to consult your bank for more specific particulars.

Letters from Readers

Montreal, June 1, 1954

A PLEA FOR A STANDARD FORM OF BALANCE SHEET

Sir: "Accounting Terminology for Canadian Practice" issued by the Canadian Institute in June 1938 defines a balance sheet as follows:

> "A balance sheet is a concise statement compiled from the books of a concern which have been kept by double entry, showing in classified form on the one side all the liabilities with the capital (and surplus, if any) and on the other side all the assets (with the deficit, if any) of the concern at a particular moment of time."

However, though the balance sheet is the show window of a concern, the general public has difficulty in understanding what lies beyond the show window.

If concerns — financial, industrial, and commercial — would only adopt a uniform method of presenting financial statements to the public, their shareholders and creditors and other interested parties would place greater confidence in their published reports than they do at present. It is, therefore, up to the members of the Canadian Institute not only to adopt this definition of a balance sheet but to adopt a uniform balance sheet for the various classes of business.

A perusal of the published 1953 annual reports of a number of Canadian corporations shows that the balance sheet is not only headed differently, but that the assets and liabilities are transposed differently. Furthermore, the order in which the assets and liabilities are listed is shown differently.

Many articles on uniformity in published financial statements have been presented from time to time in *The Canadian Chartered Accountant*, but it is evident from the 1953 published annual reports of our Canadian corporations that very little cognizance has been taken of the advice offered. There is urgent need for arriving at a uniformity which would redound not only to the benefit of the corporations, investors, and creditors but also to the members of the Canadian Institute who act as auditors of these corporations.

MORRIS GOODMAN, C.A.

Toronto, July 28, 1954

"TAXATION YEAR"

Sir: The article on "Differences between the Federal and Quebec Income Tax Acts" by Redmond and Hamilton Quain which appeared in your July issue should be very useful for those who have not yet made a detailed comparison of the two enactments.

I was surprised to find, however, that the article did not mention what is to me the most curious aspect of the Quebec legislation. It may have been noted by others that the expression "taxation year" is defined as follows — "Taxation year means each of the calendar years 1954, 1955 and 1956". Strictly construed this would appear to mean that where the phrase "taxation year" appears in the Act it must be read to mean all three years. It would thus seem that the Legislature has imposed not three income taxes but nine. It may be of course that it is not intended to interpret the section in this way.

J. HARVEY PERRY,
Director,
Canadian Tax Foundation

The Students' Department

J. E. Smyth, C.A., Editor

(*Correspondence with the editor is cordially invited*)

NOTES AND COMMENTS

ACCOUNTANTS and students-in-accounts who have suffered from an inferiority complex for not having been featured in modern fiction must view the film *Executive Suite* with mixed feelings.[1] There may even be some who will wish to slip quietly out the fire exit when the picture is over.

There are three related issues at stake in *Executive Suite*. The first issue is whether the comptroller Mr. Shaw (Fredric March) — a "human cash register" and "night school C.P.A." — or the design engineer Mr. Walling (William Holden) should be president of the Tredway Corporation. The character of the accountant suffers in comparison with that of the production man and, apart altogether from the fact that anyone who is married to June Allyson in a picture is bound to be the hero, there is applause throughout the theatre when the production man wins out.

The second issue is whether the objective of business is the maximization of the profit figure or the production of a quality product. The two objectives may not be necessarily incompatible but in the present case the price structure of the company calls for the manufacture of a cheap product which is an insult to the craftsmanship of the workmen.

The third issue is whether it is better to pay out profits in dividends to shareholders or to plough them back in. There is an eloquent plea on the part of the design engineer for financing by retained earnings as a means of improving the production processes. The plea is, in fact, so eloquent that even a shareholder is convinced by it; though we must note that the lady shareholder in question (Barbara Stanwyck) was hardly in a rational state at the time. (We do not mean to imply, however, that financing by retained earnings is never a proper method of finance.)

The picture is notable also for the fact that it draws attention to a most reprehensible act by one of the directors, who sells short in the stock of his company when he learns before the market does that its president is dead. We are pleased to think that such a breach of trust is not at all typical of company directors; nevertheless, the Companies Act (Canada) provides penalties for directors who "speculate" in the stock of their company, and both the Companies Act (Canada) and the Corporations Act, 1953 (Ontario) require disclosure of the

[1] Unfortunately we must prepare these notes two months in advance of their publication because of printing arrangements.

changes in the holdings of company shares on the part of the directors, if requested by the shareholders.

We doubt if many qualified accountants would seriously aspire to the position of president of a company — at least not unless in addition to being financial experts they were also all-round fellows (no pun intended). For all the accountant comes off second best, *Executive Suite* does contain a kind of inverted compliment for accountants. Mr. Shaw is infallible in his grasp of the financial affairs of the business and if he is not the proper person for president, he is at least indispensable. But we fear that we shall have to wait at least another ten years before an accountant is featured in a play, a movie, a novel, or even a television show; and goodness knows how long before he is pictured as a genial good-natured chap with a pretty wife and a flair for western music.

HOW TO PASS EXAMINATIONS

(From *The Accountants' Magazine, journal of the Chartered Accountants of Scotland, April,* 1954)

Candidates for the Institutes' examinations are invited to ponder the following comments which appear in the periodical report of the Examining Board to the Council which deals with the December 1953 diet of examination:—

(a) In many cases, candidates' answers show that they are relying too much on what they have been told in lectures while failing to grasp essential underlying principles, with the result that questions set on a familiar subject but in a form different from that used by a lecturer are often badly answered. Candidates should beware of the pitfalls of "cramming" themselves and should concentrate on the knowledge and application of general principles.

(b) It is not merely desirable but essential that, before a start is made on answering a question, it be carefully read so that the answer is confined to dealing with what has been asked, as information not called for does not gain marks, however correct it may be. Many candidates, if they observed this advice, would find that they had more time in which to answer a paper.

(c) The quality of an answer is judged not by its length but by its content, and it is a reasonable assumption that to questions carrying few marks long narrative answers are not expected.

(d) Too many scripts are untidy, ill-written and mis-spelt, and frequently the style adopted in answering questions is not good. Where the presentation of figures is required candidates should appreciate that a statement is a better vehicle for clear exposition than a narrative answer.

(e) A minute or two spent in considering the reasonableness of the answer given may well draw attention to a glaring error, caused by a simple copying or arithmetical mistake at an early stage of a calculation, which has vitiated all deductions from such figures. Even if the mistake is not corrected a comment on the fact that it must exist would show some appreciation of the practical applications of what has been worked out.

CORRESPONDENCE

Victoria, B.C.

Sir: Problem I in the June 1954 issue of *The Canadian Chartered Accountant* draws attention to a difficulty in answering questions which could well mean the difference between pass or failure in examinations.

The examiner's comments on this question refer to the fact that most candidates omitted from their solution the basis of valuation of inventories and fixed assets; presumably those candidates lost marks accordingly.

Now, there is continually being impressed upon students the importance of:—

(1) answering only what the question asks
(2) not reading more into the question than is actually there.

You will note that the problem does not state that the fixed assets are priced at cost (they could be appraised values) nor that the inventory was valued at the lower of cost or market. Why therefore should candidates be penalized for omitting from their answers information which is not provided in the problem?

Whilst standard accounting practice requires a reference to the basis of valuation surely it would be bad practice for the embryo Chartered Accountant to put in such reference when he is not in possession of the facts.

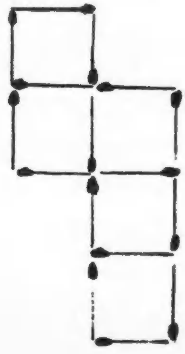
It could of course be argued that the candidate should overcome his difficulty from apparent omissions or ambiguities by making any necessary assumptions. However, this involves annotating his answers and penalizes him in another way, by the consumption of precious examination time.

M. H. ROBINSON

Editor's Note: The above letter has been referred to one of the persons concerned with the C.A. examinations who replied that when a student is asked to prepare a balance sheet he should know by the intermediate level that good accounting practice requires disclosure of the basis of valuation of both inventories and fixed assets. Students who made *no* reference to *a* basis of valuation were penalized, but it was not necessary for them to set out the particular bases shown in the published solution in order to obtain marks. Any acceptable basis was given credit.

PUZZLE

Arrange 16 matches to form five squares, as follows:



By moving two matches only, form four squares of the same size, each square touching at least one other square, without using two matches side by side.

(Contributed by Mr. Melvin A. Salak, C.A., Wexford, Ontario in response to the editor's request for more puzzles)

(The solution will appear next month)

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner, but rather to provide such discussion and explanation of the problems as will make their study beneficial. The editor will welcome discussion of the solutions published.

PROBLEM 1

Intermediate Examination, October 1953

Accounting II, Question 1 (10 marks)

The A Co. Ltd., incorporated during the year under the Companies Act, 1934 (Canada), has an authorized capital stock of 50,000 shares of 6% cumulative preferred with a par value of $100 per share, and 100,000 common shares of no par value. All the preferred shares have been issued at par but 10 shares were forfeited for non-payment of the final call of $25. These forfeited shares were later sold for $99 per share. 50,000 common shares of no par value were issued for fixed assets at a value of $500,000 and the remainder were issued for cash at $9 per share.

Required:

Prepare the shareholders' equity section of the balance sheet of the A Co. Ltd., assuming that the profits on operations for this first year retained in the business were $1,462,000.

A SOLUTION

THE A CO. LTD.

Shareholders' equity

Share capital			
Authorized:			
6% Cumulative Preferred — 50,000 shares of $100 par value	$5,000,000		
Common — 100,000 shares of no par value			
Issued and paid during the year:			
6% Preferred — 50,000 shares		$5,000,000	
Common, no par value —			
50,000 shares for fixed assets	500,000		
50,000 shares for cash	450,000		
		950,000	
Total paid-in capital		5,950,000	
Earned Surplus		1,462,740	
Total shareholders' equity			$7,412,740

PROBLEM 2

Final Examination, October 1953

Accounting II, Question 5 (20 marks)

The B. Co. Ltd. has been a well managed and successful medium-sized manufacturing company. The management believe that if operations can be expanded by approximately 50% the net profits will be enhanced considerably, and have put two proposals to raise the needed funds before the shareholders:

(a) to issue common shares,
(b) to borrow the funds by way of a bond issue.

Required:

(12 marks) (a) From the standpoint of the present common shareholders, list the advantages and disadvantages of each of the methods of obtaining the additional finances.

(8 marks) (b) List the information you, as a present shareholder, would want to have in order to determine which of the proposals you would choose.

A SOLUTION

(a) Evaluation of Financing Alternatives from the Standpoint of Present Shareholders

The Issue of Common Shares

(i) *Advantages*

1. There will be no fixed charge against earnings.
2. There will be no long term liability to be repaid out of revenue.
3. If further financing is required in the future the financial structure of the company will make it easier to obtain the needed money at that time by a bank loan or an issue of bonds.
4. A wider diversity of shareholders should create a better market for the shares, and will make them easier to sell. It will assist present shareholders in planning their estates because their shares will be more marketable.
5. No assets of the company will be pledged as security.
6. It may be easier for the company to float shares than bonds. Shares are now more attractive than formerly to investors because of the dividend credit which can be deducted in computing taxable income.

(ii) *Disadvantages*

1. There is a possibility that present shareholders will lose control if the new issue is not sufficiently scattered.
2. The earnings of the company will be spread over more people and if the future earnings do not increase proportionately with the share capital, the profit per share will be reduced.

The Issue of Bonds

(i) *Advantages*

1. The bonds may be retired out of future earnings, leaving a greater equity in earnings to present shareholders.
2. Bond interest is an allowable tax deduction whereas dividends are not.
3. Control remains with the present shareholders.

(ii) *Disadvantages*

1. Assets of the company are generally pledged as security.
2. In case of liquidation the bondholders rank before the shareholders.

3. There is a fixed commitment for interest and generally an amount must be set aside for redemption of the bonds by way of a sinking fund. These requirements will decrease working capital and the cash available for shareholders' dividends.
4. The trust deed generally contains restrictions which may prove onerous to the business.
5. If the requirements of the trust deed are not followed the bondholders will take over control of the company.
6. The cost of financing is not allowed as a deductible cost for tax purposes, and the initial cost of issuing bonds is usually higher than that of issuing shares.

(b) Information Required to Determine the Preferable Alternative

1. Pro forma profit and loss statements and balance sheets for each proposal.
2. The bond interest rate that would be required.
3. Other terms of the contemplated bond issue.
4. The future expected earnings of the company and an assessment of business prospects in that line. Is a market available for increased sales?
5. The market conditions with regard to an issue of (a) bonds, (b) common shares.
6. The total costs of an issue of each type.
7. If common shares are to be issued, are "rights" going to be issued to existing shareholders?
8. Is it possible to finance part of the proposed expansion by a bank loan if part is also financed by an issue of shares?
9. Assuming the business will be profitable in the future, what amount of assets will be retained over the next few years as a result of recording depreciation?
10. What are the proposed terms of redemption for the bonds?
11. At what price would the shares be issued?
12. How much money does the company require? How much money must present shareholders invest if the new shares are to be issued in such a way as to maintain their present equity?
13. Assuming the common shares are to be without par value, what allocation would be made of the proceeds of the issue?

PROBLEM 3

Final Examination, October 1953

Accounting II, Question 6 (12 marks)

The fixed asset accounts of W Co. Ltd. as at 31 Dec 1951 and 1952 appear as follows:

	1951	1952
Machinery and equipment	$500,000	$580,000
Buildings	250,000	290,000
Land	20,000	25,000
Projects in progress	75,000	nil
	845,000	895,000
Accumulated depreciation	200,000	273,600
	$645,000	$621,400

Upon reviewing the accounts for 1952 you find:

(a) Projects in progress represented the cost to 31 December of a new building extension $20,000, and equipment received for installation therein, $55,000. Upon completion of the building in May 1952, and the installation of the equipment, the total cost was distributed from this account to the machinery and building accounts.

(b) Machinery and equipment disposals during the year were as follows:
No. 1 purchased 1947 for $16,000, sold for $3,000
No. 2 purchased 1950 for $12,000, sold for $5,000
The company has always provided depreciation on a straight line basis at 10% on the closing balance of the fixed asset accounts. The adjustment for these disposals had been made. It was company policy to write off all profits and losses on disposals to profit and loss.

(c) A credit of $4,000 in building account represented a refund of an amount billed twice in error during January 1952.

(d) A review of the account accumulated depreciation indicates that the provision for the year has been properly recorded. There is a debit entry of $3,000 in this account representing the cost of two electric motors. Upon enquiry you are informed that these merely replace two similar motors purchased 12 years previously for approximately the same cost and which are now fully depreciated.

(e) Cost of buildings include $7,000 for architects' fees which was paid by the issue of 1,000 no par value shares of W Co. Ltd.

(f) The recorded net profit for the year was $120,000.

Required:

What items and amounts will be shown in your statement of source and application of funds with respect to the above?

A SOLUTION

W CO. LTD.

ITEMS AND AMOUNTS WHICH WILL APPEAR IN
A STATEMENT OF SOURCE AND APPLICATION OF FUNDS
for the year ended 31 Dec 1952

Sources of Funds		
Net profit for year		$120,000.00
Add depreciation		87,000.00
Loss on disposal of machinery		9,600.00
		216,600.00
Proceeds of sale of assets		8,000.00
		$224,600.00
Applications of Funds		
Fixed asset additions:		
Machinery and equipment		$108,000.00
Electric motors		3,000.00
Building	$40,000	
Less Architect's fee	7,000	33,000.00
		144,000.00
Less amount in process		75,000.00
		69,000.00
Land purchased		5,000.00
		$ 74,000.00

PROBLEM 4

Final Examination, October 1953

Auditing I, Question 1 (10 marks)

The B Co. Ltd. decided to issue first mortgage bonds. On 30 Apr 1953 the directors called for tenders. The highest bid was accepted and on 31 May 1953 the bonds were sold to the successful bidder for $99.50 per $100 bond. The bonds were issued in accordance with a trust deed, the terms of the issue being as follows:

(a) Par value of the issue to be $5,000,000.

(b) Bonds to be redeemed at the rate of $500,000 per year starting 31 May 1963.

(c) Interest to be at 5½% per annum payable 31 May and 30 November each year.

(d) Trustee to be the registrar of bonds.

The entries recording the issue of bonds were made in June 1953 and at that time the discount on the issue was written off to the earned surplus account in accordance with the resolution of the directors.

Required:

The verification procedures that would be adopted by the auditor in connection with:

(6 marks) (a) The original issue of the bonds, and

(4 marks) (b) bonds outstanding and the related balance sheet accounts as at the year end date, 30 Sept 1953.

A SOLUTION

(a) Audit Procedures to Verify Original Issue of Bonds

1. Examine the by-laws of the company to see that such borrowing is within the powers of the directors and that all the requirements of the by-laws have been observed.
2. Examine the minutes of the directors' meetings for authority of the issue, acceptance of the bid of $99.50, and the terms of issue.
3. Check the actual tender accepted and also examine the rejected bids.
4. Examine the trust deed to ascertain that its provisions have been carried out. Note pertinent information such as the sinking fund requirements, and restrictions on current assets, dividends, and surplus.
5. Check the receipt of $4,975,000 in the cash book.
6. Check the detail of the charge to earned surplus for discount on the bonds issued.

(b) Audit Procedures to Verify Bonds Outstanding and the Related Balance Sheet Accounts as at 30 Sep 1953

1. Confirm directly with the trustee the amount of bonds issued and outstanding as at 30 Sep 1953.
2. Check to see that the provisions of the trust deed have been observed.
3. Check the accrued interest on bonds as at 30 Sept 1953 and see that this amount has been set up in the accounts and charged to Bond interest expense account.

5. See that the bond discount is set out as a deduction in the statement of surplus for the year ended 30 Sep 1953.

THE TAX REVIEW

Melville Pierce, B.A., LL.B., Editor

[1954] SEPTEMBER Part 2

INCOME TAX APPEAL BOARD CASES

Fabio Monet Esq., Q.C. (Chairman) Cecil L. Snyder Esq., Q.C., (Assistant Chairman) W. S. Fisher Esq., Q.C. and R. S. W. Fordham Esq., Q.C.

Seagull Steamship Co. of Can. v. M.N.R.

Business Profits — Repairs to ship pending sale — Whether revenue or capital expense — Canadian Vessel Construction Assistance Act — Proceeds of sale of ships applied to construction of lake ships — Disapproval of Maritime Commission — Recapture of capital cost allowances — ITA 1948 s. 20(1)

Appellant purchased two vessels from the Canadian Government in 1947 and in 1951 arranged for their sale, but before transferring the vessels made substantial repairs and improvements to each, the cost being $13,072 for one and $50,870 for the other. After executing these repairs appellant sent one of the vessels on a cargo-carrying voyage and earned therefrom $23,000, and on her return transferred her to the purchaser. The second vessel was transferred immediately after the repairs were executed. The company claimed a deduction of the cost of the repairs to both vessels in its tax return for 1951, but the Minister disallowed this deduction and also added back $5,962 as recaptured capital cost allowances under ITA s. 20(1). Appellant contended that s. 4(1) of the Canadian Vessel Construction Assistance Act RSC 1952 c. 43 applied to exclude recapture on the ground that the proceeds of sale had been "used for replacement under conditions satisfactory to the Canadian Maritime Commission" within the meaning of that phrase in the said subsection. It appeared that the proceeds of sale had been applied to the construction of lake vessels and that the Canadian Maritime Commission, while it had approved the placing of the proceeds of sale in escrow without committing itself to acceptance of the proposed replacement, had subsequently rejected appellant's claim for relief under s. 4(1) on the ground that the replacing vessels were not ocean-going ships.

Held (Mr. Fordham), (1) appellant was entitled to a deduction for the repair costs of the ship which was sent on an income-earning voyage after the repairs were performed but not for the repair costs to the ship which was transferred to the purchaser immediately on execution of the repairs: *Montship Lines Ltd.* v. *MNR* [1953] Tax Rev. 115, followed.

(2) The Canadian Maritime Commission acted within its powers under

s. 4(1) of its statute in disapproving the application of the proceeds of the sale of the two vessels to the construction of lake vessels.

Que, Feb 15/54 *Allowed in part*

163 v. M.N.R.

Business Profits — Sales commissions repayable on cancellation of contract — Advances to salesmen — Reserve for uncollectible portion of debt — Onus of proof — ITA s. 11(1)(d), 12(1)(e)

Appellant was a general agent for a casualty insurance company and employed salesmen to sell policies. The general agent was entitled to a commission of 50% of the amount of the first premium, which was divided 30% to the sales agent and 20% to the general agent. The sales agents were paid their commission weekly out of the first premium received, and if the policy was subsequently cancelled or an application for a policy was not accepted by the insurance company the premium had to be returned and the salesman became liable to refund to appellant the commission previously received. Appellant also advanced money to salesmen to enable them to carry on, such advances being charged against them and deducted from commissions earned by the salesmen. In his balance sheet at the end of each year appellant showed the amount owing him by salesmen for refunds on cancelled or rejected policies and on advances made "less reserve for overdrawn accounts", the latter being the amount so repayable by salesmen estimated to be uncollectible. In some cases, with a view to encouraging salesmen who were valuable to the business, appellant forgave part of their debts, the amount forgiven being treated as additional commission to the salesmen and charged as an expense of the business. The total amount owing by salesmen in the year under review was some $7,850, about equally divided between refundable commissions and advances made, and the amount of the reserve claimed by appellant was $5,480. Appellant claimed that the latter amount was a proper deduction in computing the income of the business for the year. The Minister disallowed the deduction on the ground that it was a reserve, the deduction of which was prohibited by ITA s. 12(1)(e). Appellant appealed, contending that the amount was deductible under s. 11(1)(d)(i) as being "a reasonable amount as a reserve for doubtful debts that have been included in computing the income of the taxpayer for that year or a previous year".

Held (Messrs. Snyder and Monet), the amount in question was an amount transferred or credited to a reserve or to a contingent account within the meaning of ITA s. 12(1)(e), and appellant had not satisfied the onus of establishing that it was deductible under s. 11(1)(d) inasmuch as he had not shown that the amount claimed as a deduction was included in computing his income for the year under review [*sic*]. *Robertson Ltd.* v. *MNR* [1944] Ex. C.R. 170; Edw. *Collins & Sons Ltd.* v. *C.I.R.* (1924) 12 T.C. 773; *Naval Colliery Co.* v. *C.I.R.* (1928) 12 T.C. 1017, applied; *Maritime Lbr. Distributors Ltd.* v. *M.N.R.* [1954] 1 Tax Rev. 57, distinguished.

Apr 5/54 *Dismissed*

Editor's Note: The point here would seem to be that inasmuch as it was in evidence that appellant forgave some of his salesmen's debts there was nothing to indicate whether the debts still outstanding were in respect of advances made to salesmen, the amount of which would not have entered into the computation of appellant's income from the business, or in respect of commissions paid to the salesmen which were repayable by them to appellant, the amount of which would of course have entered into the computation of appellant's income from the business; and that since the onus of proof was on appellant he must necessarily fail where this question was left in doubt.

159 v. M.N.R.

Business Profit or Capital Gain — Company buying and selling securities — Whether dealing in securities or changing investments — Intention — Charter powers — Whole course of conduct

Appellant company was incorporated in 1938 with wide powers to deal in land and mortgages and also to invest in, buy, sell, or otherwise deal in bonds, debentures, stocks, and shares. It was originally incorporated as part of an arrangement between certain other companies for the disposal of certain mortgages of land and real estate, and pursuant to this arrangement appellant purchased for $475,000 certain real estate which was not readily saleable and mortgaged the land to a certain life insurance company for $570,000 on terms calling for any moneys realized on the sale of the land to be applied to the mortgage debt, the whole purpose of appellant company (according to the evidence of its president) being to liquidate the real estate as soon as possible. Prior to the complete liquidation of the real estate the company invested any available funds in bonds of the Dominion of Canada and of a certain Province, its object (according to its president) being to obtain the best possible return of income and to preserve its capital. By 1946 all the real estate had been liquidated and in that year appellant became the subsidiary of a company whose business was that of a security dealer. Thereafter appellant ceased dealing in lands and mortgages and thereafter looked for investments in developing industries with a view (according to its president) of increasing the return on its invested capital, and temporarily placed its funds in Dominion of Canada bonds pending the finding of a suitable investment. Between 1946 and 1952 appellant bought and sold Dominion of Canada bonds and sold common shares in four companies, acquired common shares of a commercial company in exchange for preferred shares of that company, and subsequently exchanged the common shares for common shares of another company. Appellant was assessed for 1949 and 1950 on profits of $7,445 and $4,936 respectively on the sale of Dominion of Canada bonds in those years, on the ground that it was in the business of buying, selling, and generally dealing in securities, shares, and bonds. Appellant appealed.

Held, (Mr. Monet), appellant was not a security dealer but an investment company and the gain was a capital gain and not taxable.

(1) Evidence of the company's investments in 1951 and 1952, i.e. in years following the years under review, was admissible to throw light on the whole course of conduct of the taxpayer: *142* v. *MNR* (Mr. Fordham) [1954] 2 Tax Rev. 177 followed.

(2) The evidence indicated that the securities which the company acquired with the proceeds of the realization of the real estate were purchased as investments and not with the intention of reselling them for profit even though their sale was contemplated; that they were held as fixed capital and not as circulating capital or stock-in-trade. The intention of the taxpayer is, however, not the sole test of the nature of a profit nor can the decision in this type of case rest on that test alone.

(3) The fact that the company had power in its charter to buy, sell or otherwise deal in securities was not sufficient to determine that in buying and selling securities it was carrying on the business of a dealer in securities; at the most it created a *prima facie* presumption which was rebuttable.

(4) The matter must be decided on what actually happened, on the deduction to be drawn from the taxpayer's

whole course of conduct viewed in the light of all the circumstances, and by this test it must be concluded that in the course it followed appellant was merely replacing certain investments with others and that when purchasing Dominion of Canada bonds its intention was not to enter into a scheme for profit-making with respect to them even though it contemplated selling them later on, and the same conclusion applies also to the purchase and sale of common shares.

Mar 27/54 *Allowed*

Granite v. M.N.R.

Business Profit or Capital Gain—Speculative house builder — Sale of land in block — Whether stock-in-trade or capital asset

Granite, a speculative builder, purchased two parcels of land in Etobicoke Township near Toronto, one parcel consisting of 17 lots and the other of 31 lots, with a view to building houses on the lots and selling them. He arranged with an insurance company to finance the erection of 48 houses on the 48 lots, had plans drawn, obtained building permits, arranged with real estate agents to sell the houses he planned to build, and commenced construction of 10 houses in one of the parcels. The basements of the houses and the septic tanks all were flooded by the run-off from adjacent higher ground, and this led to complaints from the purchasers, and to the refusal of the insurance company to advance any further moneys to Granite. He was thus financially unable to proceed with his plans and arranged to transfer to another builder the 31 lots on the other parcel, together with the purchasers' deposits on them, the building plans for the houses to be erected thereon, the building permits, etc., at cost plus $10,000. He was assessed to income tax for 1950 on $9,738, being the net profit realized by him in the above circumstances.

Held (Messrs. Monet, Fisher and Fordham), the amount in question was income of appellant and subject to tax. In the trade of building houses for sale the land on which the houses are built is part of the stock-in-trade of the business and not a capital asset. *Shadbolt* v. *Salmon Estate,* 25 T.C. 52, per Macnaghten J. at p. 57, applied; *Sutton Lbr. & Trading Co.* v. *MNR* [1953] 2 S.C.R. 77, distinguished; the purchase and sale of land by a builder is so closely connected with his business that it should be considered as part of it: *Kennedy* v. *MNR* [1952] Ex C.R. 258, referred to; *Williscroft* v. *MNR,* 52 DTC 334, 7 TABC 118, distinguished.

Ont, Mar 18/54 *Dismissed*

McLennan v. M.N.R.

Business Profit or Capital Gain — Speculative builder "investing" in land near his subdivision — Sale at profit — Nature of profit

Between November 1941 and May 1949 McLennan built and sold approximately 135 houses upon fully serviced lots. Late in 1948 he decided to build on land bought and subdivided by himself, and in October 1948 he bought 36 acres of land near Toronto, had a survey made and a plan of subdivision drawn up and, on it being approved, built and sold 109 houses on the land. At the time of purchasing the 36 acres abovementioned he was aware that there were 45 acres of vacant land for sale in the immediate neighbourhood and in November 1948 he offered to buy the 45 acres, which offer was refused, but after further negotiations he bought the 45 acres in June 1949 for $58,000 cash. In November 1949 a real estate agent offered to buy 26 of the 45 acres for a client for $60,000, which McLennan refused. The real estate agent gradually raised his offer until it reached $100,000, which was still refused. McLennan was then asked

to set his price, and he asked $114,000, which price was accepted. He was assessed to income tax in respect of $74,736, the amount admitted by McLennan as the net profit realized by him on the sale. He appealed, and testified that he had bought the 45 acres for investment purposes only, with the intention of holding the land until he might need cash, in the belief that the purchase price was low enough that he would not lose any money when selling it, and that when buying it he had no specific intention of reselling it and that although he had considered when buying it that it could be used for subdivision purposes he had had no definite intention of doing so; that he sold the land at the price offered because he could hardly afford to keep that amount of money tied up. At the time of the purchase the land in question was not yielding any revenue.

Held (Mr. Monet), in view of the fact that McLennan was a builder of considerable experience, that he had bought other land nearby and was building houses thereon, that he admitted that the land in question could be subdivided, that at the time of purchase it was not yielding any income, that it could be assumed that he did not anticipate that it would yield any income, it must be found that when purchasing the 45 acres McLennan did not make an investment within the true meaning of that word, i.e. primarily for the maintenance of an annual return (see Rand J. in *Gairdner Securities Ltd.* v. *MNR* [1954] CTC 24, 54; DTC 1015). The only deduction to be drawn from his whole course of conduct was that he purchased the land with a view to subdividing it in lots in due course for the erection of houses thereon, i.e. to be used in the normal carrying on of his business. The transaction of purchase and sale was so closely associated with his business that the profit therefrom was of an income nature. *Granite* v. *MNR* [1954] 2 Tax Rev. 172 referred to.

Ont, Mar 22/54 *Dismissed*

Wisenthal v. M.N.R.

Dominion Government Annuity — Conversion of deferred annuity to immediate annuity — Whether an "enlargement" of annuity — Taxability of income portion — ITA 1948 s. 71(2) (1951)

In November 1935 Wisenthal entered into a contract with the Canadian Government Annuities Branch calling for payment to him of an annuity of $600 commencing in 1968. In June 1950 Wisenthal exercised an option in the contract to convert the annuity into an immediate annuity on payment of an additional sum of $9,132, and annuity payments of $600 a year, guaranteed for 10 years, became payable immediately. The Minister assessed Wisenthal to income tax on the income portion of the annuity paid to him in 1951, namely $316. Wisenthal appealed.

Held (Mr. Fordham), the acceleration of the annuity payments effected by the conversion constituted an "enlargement" of the annuity within the meaning of ITA 1948 s. 71(2)(a). *Cameron* v. *MNR* (ITAB) [1950] Tax Rev. 170, distinguished as having been decided under the *IWTA*.

Que, Dec 16/53 *Dismissed*

126 v. M.N.R.

Benefit Conferred on Shareholder by corporation — Sale of shares at less than market price — Income — ITA s. 5(a), 8(1)(c)

Appellant company which had the right to sell its own shares had on hand a number of shares of its own stock which it had acquired some years earlier as a result of an amalgamation, and car-

ried them on its books at $7.02 a share though their market value was much higher. In 1948 the company decided to make some of these shares available to certain of its senior officials in order to strengthen their interest in its affairs, and appellant, an official of the company and also a shareholder, duly purchased 100 of the shares at $7.02 each although they were then quoted on the exchange at $20.50. The company intended that he should retain the shares but he was not obliged to do so. The Minister assessed him to income tax on the difference between what he paid for the shares and their market price under ITA 1948 s. 5(a) and 8(1)(c) as being a benefit resulting to him from his employment and also a benefit conferred on him as a shareholder by the corporation.

Held (Mr. Fordham), appellant received a benefit in money's worth of the difference between the cost price and market price of the shares and he was therefore subject to tax on the amount: *Weight* v. *Salmon* (1935) 19 T.C. 174, followed; *Ede* v. *Wilson* (1945) 26 T.C. 381, referred to.

Nov 13/53 *Dismissed*

MacDonnell v. M.N.R.

Fiscal Periods—Change in—Election to pro-rate tax—ITA 1948 s. 34A—Retirement of partner from firm and acceptance of employment — Whether change in fiscal period of individual or partnership

MacDonnell was a member of a firm of chartered accountants, whose fiscal period ended on February 28 in each year. On October 31, 1950 he retired from the firm to accept an office of employment. In his income tax return for 1950 he reported his income from the partnership for its fiscal year ending February 28, 1950 together with his income therefrom for the period March 1, 1950 until his retirement on October 31, 1950, and also his income from his new office for the months of November and December 1950, that is, for 671 days in all. MacDonnell contended that ITA 1948 s. 34A applied, however, to enable him to pay a reduced amount of tax.

Held (Mr. Fordham), in order to obtain the benefit of s. 34A there must be either a change in the taxpayer's fiscal period as an individual or a change in the fiscal period of a partnership of which he is a member, neither of which occurred here.

Man, Dec 22/53 *Dismissed*

136 v. M.N.R.

Personal Corporation—"Active commercial or industrial business"—Ownership of factory, solicitation of clients for lessee—ITA 1948 s. 61(8)

Until January 1, 1949 a company controlled by appellant manufactured soap and similar products in a factory which it owned, but commencing on that day it ceased its manufacturing business and thereafter derived its revenue from a lease of its factory to a manufacturer of similar products, the rent payable being a percentage of 1% of the lessee's gross sales plus a percentage of 1% of all sales of products manufactured by the lessee. The company expended certain moneys on additions to the mechanical equipment of the factory and gave all possible assistance to the lessee, both by counsel and through direct solicitation of orders for the lessee. Appellant was assessed to income tax for 1950 on the portion of the company's income of that year attributable to him on the footing that the company was a personal corporation within the meaning of ITA 1948 s. 61(8). Appellant appealed, contending that the company was not a personal corporation in that it carried on an active

financial, commercial, or industrial business in the year.

Held (Mr. Monet), it could not be said that the company carried on an active commercial or industrial business because it retained ownership of its factory, made certain additions to the factory equipment in compliance with the terms of its lease, and occasionally encouraged prospective buyers to buy from its lessee. The corporation itself admitted that its income for 1950 was not from an active commercial or industrial business by describing its income for that year as "rents" in its income tax return for 1950.

Dec, 22/53 *Dismissed*

Danforth-Woodbine Theatre Ltd. v. M.N.R.

Bad Debts — Film exhibitor advancing money to distributor for film rights — Deductibility of amount uncollectible — ITA (1951) s. 11(1)(e), 12(1)(a)

In 1948 appellant company, which was incorporated under the Ontario Companies Act, advanced $6,680 to a distributor of films to assist him to import into Canada a film which was to be rented to appellant for exhibition in its theatre. The film was first shown at another theatre and its further showing was then prohibited by the censor with the result that appellant never obtained the film for exhibition in its theatre. The distributor repaid appellant only $812 of the moneys advanced to him by appellant and then became insolvent and disappeared. In 1951 appellant wrote off the balance of the advance, $5,867, as a bad debt, but the Minister in assessing appellant to income tax for 1951 included the amount so written off in the computation of appellant's income. Appellant appealed. It was a custom of the film trade for exhibitors to advance money to distributors in order to make specialty films, such as the one involved here, available for exhibition. Under the Ontario Companies Act, R.S.O. 1950, c. 59, s. 23(1)(k) a company incorporated thereunder possessed the incidental and ancillary power to lend money to customers and others having dealings with the company.

Held (Mr. Fisher), appellant was entitled to deduct the business loss sustained by it as above-described. Such deduction was prohibited neither by ITA s. 12(1)(a), which prohibits outlays and expenses except to the extent they were made for the purpose of gaining or producing income from property or a business, nor by s. 11(1)(e) which permits the deduction of debts established to have become bad in a taxation year.

Ont, Jan 8/54 *Allowed*

Borenstein v. M.N.R.

Bad Debts — Sale of accounts receivable less reserve for doubtful debts — Not a bad debt loss — ITA s. 6(1)(e), 11(1)(e)

Borenstein operated a furniture store in Pembroke, Ontario, and in his tax return for 1949 claimed and was allowed a reserve of $2,700 for doubtful accounts. In November, 1949 he caused the incorporation of a company and on January 1, 1950 sold the company all the assets of his furniture business, amongst the assets being accounts receivable from customers in the amount of $23,945, which, however, were valued at $21,245, i.e., the amount of the reserve was deducted therefrom. Pursuant to ITA 1948 s. 6(e) appellant was assessed to income tax for 1950 in respect of the reserve for doubtful debts deducted by him in 1949, but he claimed to be allowed a deduction of equivalent amount in 1950 under s. 11(1)(e) on the ground that debts of that amount were established by him to have become bad in 1950.

Held (Mr. Fordham), dismissing the appeal, there was no evidence that the debts had become bad and moreover after the sale of the accounts receivable to the company on January 1, 1950 the debts were no longer owing to Borenstein as required by s. 11(1)(e).

Ont, Apr 29/54 *Dismissed*

Fueloil & Equipment Ltd. v. M.N.R.

Reserves & Contingent Accounts (1950) — Amounts received under equipment service contracts — No deduction allowed for amount unearned—ITA s. 12(1)(e)

Appellant company sold oil heating equipment and serviced the equipment sold under service contracts which it entered into with purchasers. These contracts provided that for a charge of $20 a year the company would perform certain specific services as well as emergency services when required and for an additional charge of $6 a year would in addition replace defective parts without charge. The contracts were firm contracts for a period of one year, but in practice appellant would permit a contract to be terminated sooner and in such case would refund an amount proportionate to the unelapsed period of the contract. In computing its income for 1950 appellant only included the amounts received on service contracts to the extent of the expired portion of such contracts, but the Minister assessed it to tax also in respect of additional receipts of $7,389.

Held (Mr. Fisher), appellant was chargeable to tax in respect of the full amount received in 1950 in respect of such service contracts, and the deduction of the unearned amounts was barred by ITA s. 12(1)(e) as being a reserve or contingent account. *Capital Transit Ltd.* v. *MNR* (ITAB) [1952] Tax Rev. 213, followed.

Ont, Jan 15/54 *Dismissed*

Campbell v. M.N.R.

Legal Expenses — Deductibility of — Defence of right to carry on catering business in violation of restrictive law — Not deductible

Appellant operated a rooming house in a suburb of Vancouver and in 1948 commenced to carry on a catering business there in violation of a provincial statute which restricted the use of private dwellings in the area. An action was brought against appellant for an injunction to restrain her from carrying on a catering business in the house in question and the action was successful at trial and on appeal. Appellant claimed that the legal costs incurred in unsuccessfully defending the action and on the appeal were deductible in computing her income for 1950 and 1951.

Held (Mr. Fisher), rejecting her claim, the legal expenses were not incurred in protecting a right which appellant had in common with all other taxpayers to carry on a catering business but were incurred by her to assert her individual claim that she could carry on a catering business at a particular location in violation of the law. The expense was not within the exception to ITA s. 12(1)(a) and was therefore prohibited from deduction.

B.C., Jan 13/54 *Dismissed*

National Trust Co. v. M.N.R.

Non-residents — Withholding tax — Oil royalties in trust for non-residents — No deduction allowed for depletion — ITA s. 96(1)(c), (6), 97(1); s. 11 (1)(b); ITReg. 1201(2) (1951)

Appellant company received in trust oil royalties from several oil wells from the total amount of which it deducted an amount in respect of depletion and distributed the balance among the beneficiaries, some of whom were not resident in Canada. In 1951 appellant deducted the 15% non-resident withholding tax on

the amount payable to the non-resident beneficiaries, i.e., after deduction of an allowance for depletion, and distributed to them also their portion of the amount deducted in respect of depletion. The Minister, in the view that the 15% tax was also payable in respect of the amount claimed for depletion, assessed appellant to tax in respect thereof. Appellant appealed, contending that the payment made to the non-resident beneficiaries out of the amount withheld in respect of depletion was a payment of capital. Under ITA 1948 s. 96(1) tax is imposed on amounts paid or credited to non-residents "as, on account or in lieu of payment of, or in satisfaciton of . . .(c) income of or from an estate or trust", and under s. 96(6) the source from which the trustee derived the income is ignored. Section 97(1) provides that the tax is payable on the amounts described in s. 96 without any deduction from those amounts whatsoever.

Held (Mr. Fisher), dismissing the appeal, in view of the provisions of s. 97(1) the deduction for depletion which is allowed under Part I of the Act is not allowable in determining the amount on which non-resident withholding tax is payable under Part II of the Act.

Alta, Jan 5/54 *Dismissed*

139 v. M.N.R.

Bequest of income charged on revenue of estate — Universal legatee also executor — Whether obligation imposed on him personally or as executor

Appellant's mother by her will gave all her property to her son absolutely, constituting him her universal legatee and appointing him her executor, and by her will directed him to pay her husband the sum of $3000 a year and her maid the sum of $50 a month out of the property of the estate for their respective lives, the said annuities to be non-payable in the discretion of the son if the revenues of the estate were so reduced that the son would not receive the amount of the annuities. The will also provided for the appointment of other executors in the event of the son dying before the provisions of the will were carried out. In computing his income for tax purposes for the years 1947, 1948, and 1949 the son did not include the amount of the annuities from the estate which were paid to the annuitants pursuant to the will, but the Minister assessed him to tax in respect thereof. He appealed.

Held (Mr. Monet), the obligation imposed on the appellant by the will to pay the annuities was not a personal obligation, i.e. one which he was required to fulfill regardless of the income received by him from the estate and which would devolve upon his heirs upon his death; under the terms of the will he was required to make the annuity payments in his capacity as executor, and accordingly he was entitled to succeed in his appeal. *Saunders* v. *MNR* (ITAB) [1951] Tax Rev. 157; *Brown* v. *MNR* (ITAB) [1952] Tax Rev. 70; *Wilson* v. *MNR* (ITAB) [1953] Tax Rev. 11, distinguished.

Que(?), Jan 11/54 *Allowed*

142 v. M.N.R.

Business — Individual — Obtaining option to subdivide and build houses — Assignment of option to company — Personal liability continued — Whether profit of an isolated turning-over of property or from a "business" — Evidence — Admissibility of evidence of subsequent similar transaction — IWTA s. 3

Appellant. who was in the coal and builders' supplies business, heard in 1945 that an extensive house-building program was proposed for a certain muni-

cipality, and after further investigation he approached the municipality and for $100 obtained an option to purchase a large tract of land from the municipality for $1500, to be exercised on or before November 15, 1945. The option agreement stipulated that the purchaser should subdivide the land and erect houses of a certain description on all the lots in the subdivision within 4 years in compliance with all building by-laws, that he should install sewers and water mains adequate to service all the houses built on the lots, build cement sidewalks and place a crushed stone surface on all streets. Early in November appellant obtained an extension of his option until December 31. He began negotiations with the Government and was about ready to enter into an agreement to build at least 50 houses but then became worried about the magnitude of the operation and, failing to obtain the interest of three or four contractors in the matter, and on the discouragement of his banker he decided not to proceed with his plans and on January 9, 1946 assigned his option for $36,000 to a company which had been formed on December 6, 1945, of which company appellant's brother (who was also his partner in the fuel business) was a principal shareholder and secretary though appellant himself held no shares in the company. The company paid appellant $18,000 in 1948 and $16,500 in 1949 for the assignment of his option, which amounts were included by the Minister in computing appellant's income for those years. The company carried through the building commitment contained in the option agreement. The document assigning the option to the company, which was executed by the municipality as well as by appellant and the company, preserved appellant's personal liability for the due performance of all the commitments accepted by him in the original option agreement. Evidence was tendered at the hearing that in 1950 appellant obtained a similar option from the municipality which he later assigned to another building company. Appellant objected to the admission of such evidence.

Held (Mr. Fordham), dismissing the appeal, this was not a mere case of purchase of a tract of land and its subsequent sale, but, in view of all the obligations and liabilities assumed and retained by appellant, a business undertaking that would have lasted a long time and consumed much of appellant's energy and attention had he proceeded alone, in addition to requiring a large financial outlay; and this in conjunction with the similar transaction of 1950 showed that it was not an isolated transaction or a mere acquiring and turning-over of property but a planned step in entering the house-building business that was repeated several years later, and, moreover, the evidence suggested that appellant got arrangements for the carrying-out of the building scheme well under way before assigning his option to the company and that he remained active behind the scenes while the actual building was going on. The profit was therefore from trade or business within the meaning of IWTA s. 3.

Held, also, the disputed evidence as to the similar transaction in 1950 was admissible as being evidence of subsequent conduct bearing on the issue in dispute: *Lincolnshire Sugar Co.* v. *Smart* (1937) 20 T.C. 643; *Nicholson Ltd.* v. *MNR* [1945] Ex. C.R. 191 (Thorson P.), applied, and also as showing a system or course of conduct on appellant's part.

Jan 29/54 *Dismissed*

146 v. M.N.R.

Gambling Winnings—Proof of—Credibility of witness—Net worth assessment —Onus of proof on taxpayer

Appellant derived certain income from the operation of a business during the

years 1948 to 1951 inclusive, but in those years his net worth increased by an additional $19,000 odd, in respect of which amount, spread equally over the above four years, appellant was assessed to income tax. He appealed, and testified that the amount in question represented the proceeds of his very successful gambling activities, and three other witnesses testified that appellant was a confirmed gambler and had the reputation of being very lucky. The Minister did not suggest any possible source of the amount in question. The Judge did not credit the appellant's evidence of his very large winnings.

Held (Mr. Fordham), in the absence of corroboration or records to support his evidence the assessment must be taken as correct. *Montaine* v. *M.N.R.* (ITAB) [1950] Tax Rev. 169, followed.

Que, Feb 11/54 *Dismissed*

Merry's Executor v. M.N.R.
Marks v. M.N.R.

Alimony and Maintenance — Separation Agreement — Payments made additional to obligation thereunder — "Periodic payments" — Meaning of — Deductibility and includibility of additional payments — ITA 1948 s. 6(d), 11(1)(j)

By a separation agreement between Merry and his wife, entered into in 1947 and subsequently incorporated in a judgment of divorce, Merry agreed to pay his wife $450 a year in twelve monthly instalments of $37.50 each for the maintenance of his two children and, in addition, all accounts incurred by the wife for the education of the children, for their medical treatment, and for their clothing. Following the divorce Merry agreed with his former wife to pay her certain additional sums for the maintenance of the children, and additional sums were paid in 1950 and 1951. In those years Merry also reimbursed the wife for certain sums expended by her in connection with the children, and other expenses incurred by her in connection with the children were paid by Merry. Merry claimed that all amounts expended as above-described were properly deductible under ITA 1948 s. 11(1)(j) in determining his income, but the Minister disallowed all payments made by him other than those made pursuant to the requirement in the separation agreement of 1947 to pay the wife $450 a year ($37.50 a month) for the maintenance of the children.

Held (Mr. Fisher), the additional sums paid by Merry were not made pursuant to the separation agreement or the divorce decree and were therefore not deductible under IWTA s. 11(1)(j), and the amounts paid pursuant to the separation agreement for the children's education, medical treatment, and clothing were not paid on a periodic basis, as required by s. 11(1)(j), and accordingly were not deductible thereunder. Periodical payments are those made recurrently at fixed, not variable, times, and not as a matter of discretion but pursuant to an antecedent obligation: *Re Supreme Legion Select Knights of Canada, Cunningham's case,* 29 O.R. 708, per Boyd C. at 715, applied.

Held, also, none of the amounts beyond the periodic payments of $37.50 a month paid by Merry to his wife directly or in discharge of accounts incurred by her in connection with the children were required to be included in computing the income of the wife under ITA 1948 s. 6(d), but the periodic payments of $37.50 a month made by Merry pursuant to the separation agreement were required by s. 6(d) to be included in computing his wife's income notwithstanding that they were received by her not in her own behalf but solely for the benefit of the children.

Ont, Feb 18/54 *Judgment accordingly*

156 v. M.N.R.

Income — Deduction of business losses from income from other sources — Whether capital losses

In 1946 appellant, who operated two drugstores, caused the incorporation of a company to carry on a business of manufacturing certain pharmaceutical supplies, such as toothpaste, bath salts, and mouth washes, and he and his wife were the sole shareholders of the company. Before the company had operated for a full year appellant purchased its assets for $11,526, waived all his claims as a shareholder, and personally continued the business formerly carried on by the company, the company's charter being duly surrendered. In each of the years 1947 to 1950 inclusive the manufacturing business was carried on at a loss, and in reporting his income for each of such years appellant deducted these losses from his income from other sources. The Minister disallowed the deduction of such losses on the ground that they were capital losses.

Held (Mr. Fordham), the losses were deductible.

Mar 10/54 *Allowed*

Julien v. M.N.R.

Retiring Allowances — Cancellation of contract of employment — Consideration for — Compensation for loss of employment—ITA (1951) s. 6(a)(v); 127(1)(ai)

Julien entered into a contract with a hardware company to be its general manager for five years at a salary of $7,000 a year and a share of the annual profits. A few months after the contract was executed the company, for personal reasons, wished to cancel it, and Julien consented to its cancellation in consideration of being paid $7,000, of which $3,500 was paid him in 1951.

Held (Mr. Monet), the sum of $3,500 so paid him was a "retiring allowance" and so assessable to tax under ITA 1948 s. 6(a)(v); it was an amount received by him "upon or after retirement from an office or employment . . . in respect of loss of office or employment" within the definition of "retiring allowances" in s. 127(1)(ai).

Que, Feb 15/54 *Dismissed*

Orban v. M.N.R.

Money-Lender — What constitutes — Deduction of loss on loans — Right to

Orban, who was in the textile business in Hungary, came to Canada with $120,000 in 1948 and eventually became assistant manager of a softwoods company, which paid him a salary and a share of the profits, his income therefrom in 1951 being more than $21,000. In 1948 he loaned the company $20,000 at 5%, the loan being unsecured and repayable on demand; in 1950 he loaned $8,000 at 4½% to a friend from Europe, the loan being repayable in three years; in the same year he loaned $20,000 at 5% to a pork packing company, of which he was then a shareholder. The latter two loans went bad, and in 1951 Orban claimed a deduction of $9,962 in respect of his ascertained loss on those two loans, contending that they were losses sustained by him in carrying on the business of a money-lender. He did not hold himself out or advertise as a money-lender and the fact that he had some money available was known only to a few individuals. He made no other loans.

Held (Mr. Fordham), the facts did not support his contention that he carried on the business of money-lending, and his appeal must be dismissed. *Litchfield* v. *Dreyfus* [1906] L.K.B. 584, per Farwell J. at 589; *Newton* v. *Pyke* [1908] T.L.R. 127 per Walton J. at 128; *Nash* v. *Layton* [1911] 2 Ch. 71, per Buckley L.J. at 82; *Newman* v. *Oughton* [1911] 1 K.B. 792, considered.

Que, Feb 24/54 *Dismissed*